SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 582

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

JAMES L. RANKIN, EXECUTOR OF THE ESTATE OF RICHARD B. TURNER, DECEASED

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

INDEX

	Original	Print
Proceedings before United States Board of Tax Appeals	1	1
Docket entries	1	1
Petition	5	2
Exhibit A—Notice of deficiency	8	4
Answer	11	5
Motion to amend petition	12	6
Suggestion of death and motion for substitution	13	6
Order amending caption	14	7
Order vacating order amending caption	14	7
Findings of fact and opinion, Smith, M	15	8
Decision	20	11
Petition for review	21	11
Statement of evidence	28	14
Caption	28	14
Stipulation as to certain facts	28	15
Testimony of—		
James L. Rankin	30	16
Thomas McDougal	36	20
Order settling statement of evidence	38	21
Praecipe for transcript of record	39	21
Clerk's certificate [omitted in printing]	40	22
Proceedings in U. S. C. C. A., Third Circuit	41	22
Stipulation as to substitution	41	22
Order substituting party petitioner	43	23
Order substituting party respondent	44	24
Minute entry of argument and submission	45	24
Opinion, Woolley, J	46	25
Judgment	51	25
Clerk's certificate	52	25
Order allowing certiorari	53	29

Before United States Board of Tax Appeals

Docket No. 53554

RICHARD B. TURNER

Amended by order of 9/23/32 to read:

JAMES L. RANKIN AS EXECUTOR OF ESTATE OF RICHARD B. TURNER

Amended by order of 10/4/32 to read:

ESTATE OF RICHARD B. TURNER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances:
For petitioner: James Craig Peacock, Esq.;
For respondent: J. M. Morawski, Esq., Prew Savoy, Esq.

Docket entries

Mar. 9, 1931—Petition received and filed. Taxpayer notified. (Fee paid.)
Mar. 9, 1931—Copy of petition served on general counsel.
Apr. 11, 1931—Answer filed by general counsel.
Apr. 16, 1931—Copy of answer served on taxpayer—General calendar.
Mar. 17, 1932—Hearing set April 27, 1932.
Apr. 27, 1932—Hearing had before Mr. Smith, division 5, on merits. Stipulation of facts read into record. Submitted to Mr. Smith. Suggestion of death and motion to substitute filed and granted. Petitioner's brief due in 45 days—none for Commissioner. Motion to amend petition filed—granted.
Apr. 27, 1932—Motion to substitute Estate of Richard B. Turner filed at hearing and granted.
June 1, 1932—Motion for 30 days extension after receipt of transcript to file brief filed by taxpayer.
June 2, 1932—Motion granted.
July 12, 1932—Transcript of hearing 4/27/32 filed.
Aug. 5, 1932—Stipulation for correction of transcript filed by taxpayer.
Aug. 5, 1932—Brief filed by taxpayer.
Sept. 23, 1932—Order amending caption of petition to read "James L. Rankin, Executor of Estate of Richard B. Turner", entered.
Oct. 4, 1932—Order to vacate order of Sept. 23, 1932, and that the caption of petition read "Estate of Richard B. Turner" as granted in motion of April 27, 1932, entered.
Oct. 14, 1932—Findings of fact and opinion rendered—Mr. Smith, division 5. Judgment will be entered for the Commissioner.
Oct. 17, 1932—Decision entered—Mr. Smith, division 5.

Jan. 6, 1933—Petition for review by Court of Appeals of D. C., with assignments of error filed by taxpayer—proof of service thereon.
Jan. 6, 1933—Petition for review by U. S. Circuit Court of Appeals (3) with assignments of error filed by taxpayer—proof of service thereon.
Jan. 6, 1933—Statement of evidence lodged.
Jan. 6, 1933—Notice of lodgment of statement and of hearing Jan. 18, 1933, to approve statement filed.
Jan. 18, 1933—Hearing had before Mr. Smith, division 5, on approval of statement of evidence—statement of evidence approved.
Jan. 19, 1933—Præcipe with proof of service thereon filed (Court of Appeals).
Jan. 23, 1933—Statement of evidence approved and ordered filed.
Jan. 31, 1933—Transcript of hearing Jan. 18, 1933, filed.
Feb. 13, 1933—Transcript of record *sur* petition for review delivered to counsel for taxpayer.
Mar. 3, 1933—Motion for six months continuance to transmit and deliver record filed by taxpayer.
Mar. 3, 1933—Order enlarging time to Sept. 7, 1933, for preparation of evidence and delivery of record entered.
Sept. 5, 1933—Motion for 6 months extension to complete record filed by taxpayer.
4 Sept. 5, 1933—Order enlarging time to 3/7/34 for preparation of evidence and delivery of record entered.
Jan. 22, 1934—Mandate from Court of Appeals of D. C. dismissing petition for review filed.
Jan. 27, 1934—Præcipe with proof of service thereon filed by taxpayer.

5 Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed March 9, 1931

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR:B-1 ARM-60D, dated January 29, 1931, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual with principal office at 8 West Sixth Street, Chester, Pennsylvania.

2. The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on January 29, 1931.

3. The taxes in controversy are income taxes for the calendar year 1928 and for $11,173.05.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in including in petitioner's income any amount in excess of $25,933.50 on account of profits on
6 sales in 1928 of United Gas Improvement common stock (hereinafter referred to as U. G. I. stock).

(b) The Commissioner erred in holding that because petitioner's records fail to specify the sales as applying to any particular parcel of stock sold the evidence therefore indicates that the identity of the shares sold cannot be determined.

(c) The Commissioner erred in using the cost of the earliest purchases as the proper basis for computing gain on the shares sold.

(d) The Commissioner erred in not using the cost of the stock received as a stock dividend in 1926 as the basis for computing gain on the shares sold on May 8, 1928.

(e) The Commissioner erred in not using the cost of the shares purchased June 8, 1928, as the basis for computing gain on the shares sold on October 22 and November 7, 1928.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) During 1926 petitioner bought 1,200 shares of United Gas Improvement Company common stock on margin through West & Company, a firm of stock brokers in Philadelphia, Pa., for $117,202.50.

(b) On November 22, 1926, a stock dividend of 25 percent was paid, so that on December 31, 1926, petitioner's account with West & Company showed 1,500 shares of U. G. I. stock long.

(c) During 1927 petitioner had no transactions in U. G. I. stock or any other stock, and at December 31, 1927, his account similarly showed 1,500 shares of U. G. I. stock long.

7 (d) On May 8, 1928, petitioner sold for $44,619 the 300 shares of U. G. I. stock which he had received as a stock dividend in 1926.

(e) On May 31, 1928, his account with West & Company showed 1,200 shares of U. G. I. stock long, and no other shares of any other stock long or short.

(f) On June 8, 1928, petitioner bought for $143,225, on margin in the same account 1,000 shares of U. G. I. stock.

(g) On October 22, 1928, petitioner sold for $73,865, half (i. e. 500 shares) of the 1,000 shares which he purchased on June 8, 1928.

(h) On November 7, 1928, petitioner sold for $74,115 the remaining 500 shares of the 1,000 shares which he bought on June 8, 1928.

(i) On December 31, 1928, petitioner still held the original 1,200 shares of U. G. I. stock which he had purchased in 1926.

(j) In the deficiency letter the respondent included in petitioner's income for 1928 $92,864 as the profit on the sale of the 1,300 shares of U. G. I. stock which petitioner sold during 1928.

Wherefore, the petitioner prays that this Board may hear the proceeding and determine that the profit to be included in petitioner's income for 1928 on account of sales of U. G. I. stock should be re-

duced from $92,864, as determined by the Commissioner, to not more than $25,933.50, and that the deficiency proposed by the Commissioner should be correspondingly redetermined.

JAMES CRAIG PEACOCK,
Counsel for Petitioner,
1366 National Press Bldg., Washington, D. C.

8 [*Duly sworn to by Richard B. Turner, jurat omitted in printing.*]

Exhibit A to petition

TREASURY DEPARTMENT,
Washington, January 29, 1931.

Office of Commissioner of Internal Revenue. Address reply to Commissioner of Internal Revenue, and refer to IT:AR:B-1 ARM-60D.

Mr. RICHARD B. TURNER,
511 Welsh Street, Chester, Pennsylvania.

SIR: You are advised that the determination of your tax liability for the year 1928 discloses a deficiency of $11,173.05, as shown in the statement attached.

9 In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,
Commissioner.
By (Sgd.) J. C. WILMER,
Deputy Commissioner.

Enclosures:
Statement
Form 882
Form 870
BH-1

10 STATEMENT

IT:AR:B-1
ARM-60D

In re: Mr. Richard B. Turner, 511 Welsh Street, Chester, Pennsylvania

Tax liability

Year	Tax liability	Tax assessed	Deficiency
1928	$12,220.39	$1,047.34	$11,173.05

The basis of this deficiency was set forth in a Bureau letter dated December 17, 1930, which is hereby made a part of this letter.

A copy of this letter is being mailed to Mr. James L. Rankin, 12–14 East Fifth Street, Chester, Pennsylvania, in accordance with the authority conferred upon him in power of attorney executed by you and on file with this office.

11 Before United States Board of Tax Appeals

Answer

Filed April 11, 1931

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, general counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.
2. Admits the allegations contained in paragraph 2 of the petition.
3. Admits the allegations contained in paragraph 3 of the petition.
4. Denies that Commissioner erred as alleged in paragraphs 4 (a) to (e), inclusive, of the petition.
5. Denies the allegations contained in paragraphs 5 (a) to (j), inclusive, of the petition.

Denies generally and specifically each and every allegation set forth in taxpayer's petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the taxpayer's appeal be denied.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of counsel:

PHILIP M. CLARK,
Special Attorney,

Bureau of Internal Revenue.

12 Before United States Board of Tax Appeals

Motion to amend petition

Filed April 27, 1932

Now comes petitioner by its attorney of record and moves that the concluding prayer of the original petition be amended to read as follows:

"Wherefore, the petitioner prays that this Board may hear the proceeding and determine

"(a) That the profit to be included in the taxpayer's income for 1928 on account of sales of U. G. I. stock should be reduced from $92,854 as determined by the Commissioner, to not more than $25,933.50, or if it cannot identify the particular 1,300 shares which were sold in 1928 at the above-mentioned prices, then

"(b) That there was no profit on the sale of any of said stock until out of the proceeds of sales there had first been recovered the total cost of all shares of such stock on hand at the time of such sale, or if it cannot so hold, then

"(c) That art. 58 of regulations 74, insofar as it may be deemed by its terms to be applicable to the facts of this case, is unreasonable and invalid, and the basis should be computed by pooling the cost of all shares on hand at the time of each sale, or if it cannot so hold, then

"(d) That art. 58 of regulations 74, if applicable, must be strictly applied according to its terms, and particularly that none of the stock sold shall be charged against stock which had been received as stock dividends."

Respectfully submitted.

JAMES CRAIG PEACOCK,
Attorney for Petitioner.
1366 National Press Bldg., Washington, D. C.

EXCERPT FROM TRANSCRIPT OF HEARING APRIL 27, 1934

The MEMBER. The amendment to the petition is granted.

13 Before United States Board of Tax Appeals

Suggestion of death and motion to substitute

Filed April 27, 1932

Now comes James Craig Peacock, attorney of record, for petitioner in this case, and suggests to the Board the death of the said petitioner, Richard B. Turner, on February 21, 1932, and moves the sub-

stitution as petitioner of the Estate of Richard B. Turner, deceased. A certificate of the appointment of James L. Rankin as sole executor of the said estate by the Orphans' Court of Delaware County, Pennsylvania, is attached to the original of this motion.

Respectfully submitted.

JAMES CRAIG PEACOCK,
1366 National Press Bldg., Washington, D. C.

Granted April 27, 1932.

(Sgd.) CHARLES P. SMITH,
Member, U. S. Board of Tax Appeals.

14 Before United States Board of Tax Appeals

Order amending caption

Filed September 23, 1932

At the hearing of this proceeding on April 27, 1932, counsel for the petitioner suggested the death of the petitioner, on February 21, 1932, and moved that the executor, James L. Rankin, be substituted as petitioner. The premises considered, it is

Ordered that the motion be granted and that the caption of the petition be amended to read "James L. Rankin, Executor of the Estate of Richard B. Turner, deceased."

(Sgd.) CHARLES SMITH,
Member.

Before United States Board of Tax Appeals

Order to vacate

Filed October 4, 1932

It appearing that the suggestion of death and motion to substitute filed by counsel for the petitioner in the above-entitled proceeding on April 27, 1932, was granted on that date, and that in error an order was entered by the Board on September 23, 1932, granting a substitution of party, it is

Ordered that the order of the Board entered September 23, 1932, be and the same is hereby vacated and set aside and that the caption of the petition read "Estate of Richard B. Turner, deceased," as granted in the motion of counsel for the petitioner on April 27, 1932.

(Sgd.) CHARLES P. SMITH,
Member.

15 26 B. T. A. —

Before United States Board of Tax Appeals

Docket No. 53554. Promulgated October 14, 1932

ESTATE OF RICHARD B. TURNER, DECEASED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Where the decedent in 1926 and 1928 purchased on margin through a broker at various times sundry lots of stock of United Gas Improvement Co., and in 1928 sold through the broker a portion of the stock thus held on margin, the respondent's determination that he sold those first acquired is approved.

James C. Peacock, Esq., for the petitioner.

J. M. Morawski, Esq., for the respondent.

Findings of fact and opinion

Filed October 14, 1932

This is a proceeding for the redetermination of a deficiency in income tax of decedent for 1928 of $11,173.05. The question presented by this proceeding is whether a sale of a portion of the number of shares of stock, owned by the petitioner through a broker on margin, shall be applied against the latest shares purchased or against the first shares purchased.

16 *Findings of fact*

1. The decedent, who died subsequent to the filing of the petition in this case, was during the taxable year here involved and for many years prior thereto president and principal owner of the Turner Supply Co., Chester, Pa. From 1924 until his death in 1932, he was sick, and from 1928 on blind, and his two closest business associates (one was his personal attorney and also the secretary of the company, and the other was manager of the company) had to and did handle a great many of his personal affairs, including the transactions hereinafter referred to.

2. Early in 1926, a distribution in kind was made of the estate of the decedent's father, at which time he received as a part of his share of the estate about $20,000 in bonds. He did not believe in bonds as an investment and desired to change his inheritance from his father from bonds into stock. He had several friends who were interested in United Gas Improvement Co. of Philadelphia, and after conversations with them decided to purchase as many shares of stock of the United Gas Improvement Co. as the funds to be obtained from the sale of his bonds would warrant. At his direction his attorney opened for him a marginal account with West & Com-

pany, a brokerage firm, and with the proceeds of the bonds he purchased on margin during the early part of 1926, 1200 shares of United Gas Improvement Co. stock at a total cost of $117,202.50.

3. On November 22, 1926, decedent was credited by his broker with 300 shares of United Gas Improvement Co. stock as a stock dividend on the 1200 shares which he had purchased, making a total of 1500 shares of that stock held on margin on December 31, 1926.

17 4. During 1927 the decedent had no marginal transactions in this or any other stock and took no active part in the market and at the end of that year his margin account showed 1,500 shares of United Gas Improvement Co. stock long. On June 8, 1928, the decedent bought through the same broker on margin 1,000 shares of United Gas Improvement Co. stock costing $143,225.

On May 8, 1928, the decedent gave orders to his broker to sell 300 shares of United Gas Improvement Co. stock, which was sold for $44,619 net. On October 22, 1928, he sold an additional 500 shares of the same stock for $73,865, and on November 7, 1928, an additional 500 shares for $74,115, making a total selling price for all of this stock sold in 1928 of $192,599.

The respondent included in decedent's income for 1928 the sum of $92,864, representing profit on the sale of 1,300 shares of United Gas Improvement Co. stock in 1928. The profit was computed as follows:

The cost of the 1,300 shares was computed at $99,735 by taking the earliest purchases in 1926 together with the 25 percent stock dividend on each such purchase as follows:

125	shares	(100+25) cost	$9,020
625	"	(500+125) "	44,475
125	"	(100+25) "	9,095
425	"	"	37,145
1,300			$99,735

This last item was computed by taking the cost of the 400 shares bought June 14, 1926 ($43,700); adding 100 shares received as a stock dividend, which would give a total of 500 shares; dividing 500 into the cost of $43,700, which would give a cost per share of $87.40; and multiplying this $87.40 by 425 (the number of shares necessary to make up the total of 1,300 shares) would give a

18 cost of $37,145 as above. The total cost of $99,735 computed as above, when deducted from the total selling price of $192,599, leaves a profit of $92,864.

The decedent always intended to retain the ownership on margin of 1,200 shares of the United Gas Improvement Co. stock since he had faith in the company and desired to hold that in lieu of the bonds which he had received from the estate of his father. In giving orders to his broker to sell 1,300 shares of the stock in 1928, the decedent did not specify any particular shares to be sold. An employee of the broker understood, however, that the decedent desired to retain 1,200 shares to take the place of the bonds which he had

received from his father. The decedent had made it plain to his associates that the 1,200 shares were in the nature of a permanent commitment on his part.

Opinion

SMITH. It is the contention of the petitioner in this proceeding that since it was the intention of the decedent to retain 1,200 shares of the United Gas Improvement Co. stock as an investment, and that since that intention was understood by his associates who gave the orders to purchase and sell the stock and by an employee of the brokerage concern, it must be assumed that the 1,300 shares that were sold by the broker in 1928 represented the 300 shares received as a stock dividend and in addition the 1,000 shares purchased by the decedent on June 8, 1928. The respondent rejected such contention in accordance with article 58 of regulations 74, which provides, so far as material, as follows:

"*Sale of stock and rights.*—When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale from the cost or other basis of the stock will constitute gain. In the case of stock in respect of which any stock dividend was paid, the basis for determining gain or loss from a sale of a share of such stock shall be ascertained in accordance with the principles laid down in article 600. . . ."

The evidence indicates that the decedent in the case at bar assumed that when he purchased shares of stock on margin a certificate for a given number of shares was acquired by him and retained by the broker. When the respondent first claimed that the decedent owed an additional tax for 1928, he, through his attorney, went to the broker's office to ascertain what certificates of stock were carried to the credit of the decedent and what certificates were actually sold for him in 1928. He learned that no certificates were earmarked for the decedent on the broker's books of account and that the broker could not advise him as to any specific certificates of stock that were purchased for him in the years 1926 and 1928. The character of the transaction is stated by the Circuit Court of Appeals for the Third Circuit in Snyder v. Commissioner, 54 Fed. (2d) 57, in the following language:

". . . The evidence of the transaction and of the customer's ownership is merely a book entry of a debit of the shares purchased against a credit of the margin paid. The shares are commingled with perhaps many thousand held by the broker for other customers, subject always to be hypothecated by him in raising the difference in money between the customer's margin and the purchase price of the shares, which of course the broker must pay in order to get a certificate. The shares are not delivered or earmarked or allocated to the customer even on the books."

20 The facts in the above referred to case are substantially the same as those which obtain in the proceeding at bar. In that opinion the court affirmed the decision of the Board in John A. Snyder, 20 B. T. A. 778. See also Skinner et al. v. Eaton, 34 Fed. (2d) 575, affirmed 45 Fed. (2d) 568, certiorari denied 51 S. Ct. 486.

The contention of the petitioner that article 58 of regulations 74 does not apply to the facts in this case and that if it does to that extent it is unreasonable and invalid is sufficiently answered by the decisions above referred to.

The petitioner makes the further contention that if the shares sold cannot be identified then under the general principles of law there was no profit on sales of these shares until the entire capital investment therein had been recovered. Petitioner relies upon Burnet v. Logan, 283 U. S. 404. In our opinion there is no merit for such a contention. Manifestly, shares of stock represent divisible interests in a corporation and where a person sells one or more of a lot of shares owned he may sustain a gain or loss in respect of that transaction.

Judgment will be entered for the respondent.

Before United States Board of Tax Appeals

Decision

Entered October 17, 1932

Pursuant to the determination of the Board, as set forth in its report promulgated October 14, 1932, it is

Ordered and decided: That there is a deficiency of $11,173.05 for the year 1928.

(Sgd.) CHARLES P. SMITH,
Member.

21 In United States Circuit Court of Appeals for the Third Circuit

B. T. A. No. 53554

ESTATE OF RICHARD B. TURNER, DECEASED, PETITIONER ON REVIEW

v.

COMMISSIONER ON INTERNAL REVENUE, RESPONDENT ON REVIEW

Petition for review

Filed January 6, 1933

To the Honorable Judges of the United States Circuit Court of Appeals for the Third Circuit:

Now comes the Estate of Richard B. Turner, deceased, by its attorney, James Craig Peacock, and respectfully shows:

This appeal was taken to the Board of Tax Appeals from a proposed deficiency of $11,173.05 in the income tax of Richard B. Turner

for 1928, Mr. Turner having filed the petition before his death on February 21, 1932. During 1926 Mr. Turner purchased on margin 1,200 shares of U. G. I. stock (on which he later received a 25 per cent. stock dividend of 300 shares). During 1928 he sold 300 shares and also purchased on margin 1,000 shares of the same stock. Later in 1928 he sold 1,000 shares of U. G. I. stock. The sole issue is the basis to be used in computing the profit on the sale of the 1,300
22 shares. The respondent arbitrarily used the cost of the first 1,040 shares purchased in 1926, which with 260 shares received as a 25 per cent stock dividend thereon totals 1,300 shares. The petitioner contends that the 300 stock dividend shares and the 1,000 shares bought in 1928 were the 1,300 shares sold in that year and that they have been identified as such; and also that for other reasons the respondent's computation of cost is in any event erroneous. The Board of Tax Appeals sustained the respondent's determination.

The Estate of Richard B. Turner, deceased, was on April 27, 1932, substituted as petitioner.

The decedent was an inhabitant of Pennsylvania and filed his income tax return for 1928 with the collector of internal revenue at Philadelphia, Pennsylvania, and the sole executor of his estate, James L. Rankin, is also an inhabitant of Pennsylvania. Review of the Board's decision is therefore sought in the United States Circuit Court of Appeals for the Third Circuit in accordance with the provisions of section 1002 of the Revenue Act of 1926.

The petitioner assigns the following errors in the determination and the decision of the Board:

1. The Board erred in holding that the 1,300 shares sold in 1928 were the first 1,040 shares purchased together with 250 shares received as a stock dividend thereon.

2. The Board erred in holding that the basic cost of the shares sold was $99,735.

3. The Board erred in failing to hold that the 1,300 shares sold were the 300 shares received or credited as a stock dividend on November 22, 1926, and the 1,000 shares subsequently purchased.
23 4. The Board erred in failing to hold that the 1,300 shares sold had been identified as said 300 stock dividend shares and said 1,000 subsequently purchased shares.

5. The Board erred in holding that the basic cost of the 1,300 shares sold was less than $166,665.50.

6. The Board erred in failing to find that the basic cost of the 1,300 shares sold was at least $166,665.50.

7. The Board erred in holding that article 58 of regulations 74 applies to the facts of this case.

8. The Board erred in failing to hold that article 58 of regulations 74 is unreasonable and invalid if it by its terms applies to the facts of this case.

9. The Board erred in failing to hold that, if the 1,300 shares sold cannot be identified, then there was no profit on the sale of any shares until there had first been recovered the total cost of all shares of such stock on hand at the time of such sale.

10. The Board erred in failing to hold that, even if article 58 of regulations 74 is valid and applicable to the facts of this case, nevertheless by its very terms no part of the stock sold may be charged against the 300 shares of stock received as a stock dividend.

11. The Board erred in failing to find as a fact that the 1,300 shares sold in 1928 were the 300 shares received as a stock dividend November 22, 1926, and the 1,000 shares purchased June 8, 1928.

12. The Board erred in failing to find as a fact that it was the 1,200 shares purchased in 1926 that the decedent always intended to and did retain as an inheritance from his father.

24 13. The Board erred in failing to find as a fact that beginning in March 1928 the decedent for the first time began active buying and selling of stocks in his margin account and that in addition to the purchase of 1,000 shares of U. G. I. stock in June and the sale of 300 shares, 500 shares, and 500 shares of that stock in May, October, and November, respectively, he in March bought and sold 1,000 shares of General Motors and also bought 1,000 shares of Packard; in April bought 2,000 shares of Public Service of New Jersey; in May sold the Packard and Public Service stock as well as the above mentioned 300 shares of U. G. I. stock with the result that at the end of May the account contained only 1,200 shares of U. G. I. stock long; in June bought 1,000 shares of General Motors and 500 shares of Hudson Motors in addition to the above-mentioned 1,000 shares of U. G. I. stock; in July sold the General Motors and 500 shares of Hudson and also bought 500 more shares of General Motors; and during the remainder of the year was even more actively buying and selling General Motors, Hudson Motors, National Power & Light, Consolidated Gas, Stanley, Electric Power & Light, Chrysler, U. S. Steel, Studebaker, Victor Talking Machine, Sun Oil, Keith-Albee, Shubert, Pennsylvania Railroad, Curtis, Kolster Radio, and A. M. Byers, mostly in 500 or 1,000 share lots.

14. The Board erred in failing to find as a fact that during 1928 decedent frequently consulted his attorney about his stock transactions and was constantly advised by the latter to sell because he believed that prices were too high; that he followed his attorney's advice as to most of his transactions except with regard to the 1,200 shares of U. G. I. stock which he had purchased in 1926; that he constantly stated to his attorney and to his other associates

25 that he regarded it as his inheritance from his father and as a permanent investment and that he would not sell it; that he conferred with the manager of the company about his stock holdings at least once a week during that year and often discussed with him the difference between his first 1,200 shares of U. G. I. stock and the shares which he subsequently bought; that there were two other friends who also visited him frequently at his country place and whenever any of the four were with him the conversation almost always was largely about U. G. I. and he constantly reiterated that the original 1,200 shares were a permanent holding but that the other shares of that stock he had bought with the hope of making a profit

by selling them; that in computing the possible profit for the purpose of deciding whether or not to sell the 1,200 shares in 1928 the taxpayer calculated it on the basis of the cost of the 1,000 shares purchased in that year, having no thought or intent that he was selling anything but those shares and in this connection he gave no thought whatever to the stock bought in 1926; and that about the middle of December 1928, he made an accurate calculation of his profit on this transaction on the same basis and reported the profit so computed in his income tax return for that year.

15. The Board erred in failing to find as a fact that from the very beginning West & Company knew the taxpayer's intentions and that he was keeping the first purchase of 1,200 shares; and that they had been so advised by his attorney, and at the time of the sale of the first 500 shares of the 1,000 shares sold late in 1928 they knew that the taxpayer understood that the sale was out of the 1,000 shares purchased during that year and that he still had the original 1,200 shares.

16. The Board erred in failing to find as a fact that decedent
26 frequently made memorandums of his stockholdings with the prices at which he would sell them and that he made such a memorandum in which he noted such a price after every item except the 1,200 shares of U. G. I. stock.

17. The Board erred in failing to find as a fact that decedent always intended to and did retain the 1,200 shares of U. G. I. stock which he purchased in 1926.

18. The Board erred in failing to find as a fact that decedent intended to and did sell in 1928 the 300 stock dividend shares and the 1,000 shares of U. G. I. stock which he purchased in that year.

19. The Board erred in entering judgment for respondent.

Wherefore, the petitioner prays that the determination and decision of the Board in this case be reviewed by the United States Circuit Court of Appeals for the Third Circuit, that a transcript of record be prepared in accordance with the law and the rules of said court and transmitted to the clerk of the said court, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said court.

JAMES CRAIG PEACOCK,
Attorney for Petitioner.

27 [*Duly sworn to by James Craig Peacock, jurat omitted in printing.*]

28 BEFORE UNITED STATES BOARD OF TAX APPEALS

Statement of evidence

Filed January 23, 1933

The above-entitled cause came on for hearing before the United States Board of Tax Appeals on April 27, 1932, James Craig Peacock representing the petitioner and J. M. Morawski representing the re-

spondent. The following is a statement of all of the evidence which is essential to the decision of the questions raised by the assignments of errors set out in the petition for review by this court.

Stipulation as to certain facts

It was stipulated as follows:

"It is stipulated by the parties that the petitioner made the following purchases of United Gas and Improvement Company stock in 1926 on margin through West and Company, brokers of Philadelphia:

Bought March 30, 1926, 100 shares, cost	$9,020
Bought March 31st, 1926, 500 shares, cost	44,475
Bought April 5th, 1926, 100 shares, cost	9,095
Bought June 14th, 1926, 400 shares, cost	43,700
Bought June 14, 1926, 100 shares, cost	10,912.50

"On November 22d, 1926, the petitioner received 300 shares as a 25 per cent. stock dividend, making a total held on margin on December 31, 1926, of 1,500 shares.

"The petitioner had no marginal transactions in this stock in 1927.

"On December 31, 1927, the petitioner's margin account showed 1,500 shares of United Gas and Improvement Company stock long.

"It is further stipulated that on June 8th, 1928, the petitioner bought 1,000 shares of United Gas and Improvement stock on margin costing $143,225.

"It is stipulated that the following sales were made on margin of United Gas and Improvement Company stock:

"May 8th, 1928, sold 300 shares for $44,619.

"Oct. 22d, 1928, sold 500 shares, of United Gas Improvement Company stock for $73,865.

"November 7th, 1928, sold 500 shares United Gas Improvement Company stock $74,115, making a total selling price of $192,599.

"It is further stipulated in computing the deficiency the respondent included in petitioner's income for 1928 the sum of $92,864 representing profit on the sale of 1,300 shares of United Gas and Improvement Company stock in 1928. The profit was computed as follows:

"The cost of the 1,300 shares was computed at $99,735 by taking the earliest purchases in 1926 together with the 25 per cent. stock dividend on each such purchase as follows:

125	shares	(100+ 25)	cost $9,020
625	"	(500+125)	" 44,475
125	"	(100+ 25)	" 9,095
425	"		" 37,145
1,300	"		" $99,735

This last item was computed by taking the cost of the 400 shares bought June 14, 1926 ($43,700); adding 100 shares received as a stock dividend which would give a total of 500 shares; dividing 500 into the cost of $43,700 which would give a cost per share of $87.40;

and multiplying this $87.40 by 425 (the number of shares necessary to make up the total of 1,300 shares) would give a cost of $37,145 as above. The total cost of $99,735 computed as above when deducted from the total selling price of $192,599, leaves a profit of $92,864."

30 JAMES L. RANKIN, witness for the petitioner, testified as follows:

Since 1913 I have been the decedent's sole attorney and also secretary of the Turner Supply Company of which he was president and principal owner. I acted also as attorney for his father's estate which was closed and distributed in kind in the spring of 1926. As part of such distribution decedent received about $20,000 of bonds. Decedent told me that he had decided to open an account with a Philadelphia brokerage house to sell these bonds and use them as the basis for purchasing U. G. I. stock. I recommended West & Company and at his request made the arrangements for opening the account procuring the usual form of marginal agreement which he signed and I returned to West & Company. At his request I directed them to purchase U. G. I. stock and I sent them the $20,000 of bonds and some cash, I think upwards of $2,000.

Decedent told me several things in explanation of his instructions, some of which I knew anyhow. He told me of many conversations which he had had with one Thompson who had been associated with him in business and formerly employed by a company which was affiliated with the U. G. I. Company and of the recommendations made by one Morrisey, an engineer in the employ of the U. G. I. Company, that he buy that stock, and that it was those two things that led him to decide to buy U. G. I. stock. "He stated he regarded his purchase, or he wanted to regard the transaction as substituting the U. G. I. stock for the inheritance he received from his father. Mr. Turner did not believe in bonds and said he . . . wanted to change his inheritance from his father from the form of bonds into stock, and desired to purchase as many shares of
31 stock of the U. G. I. Company as the funds to be obtained from the sale of his bonds would warrant."

The instructions for these purchases were all given by letter or telephone to a Mr. Carey, who was employed with West & Company.

The decedent's very first purchase through West & Company was for 50 shares of U. G. I. stock outright, the certificates for which were delivered to him. His only purchase in that year other than U. G. I. stock was a purchase of 80 shares of Philadelphia Electric. In 1927 his only transactions were the sale of 15 shares of U. G. I. stock which he had received as a stock dividend on the said 50 shares and on 10 other shares which he had received from his father's estate, and a sale of a few shares of the Philadelphia Electric stock. In March 1928 the situation changed and he began to buy a number of stocks in this account, including some additional purchases of U. G. I. stock. On March 14 he bought 1,000 shares of General Mo-

tors, and on March 27 he sold 1,000 shares of General Motors. On March 26 he bought 1,000 shares of Packard, and at the end of March 1928 was long the 1,500 shares of U. G. I. and 1,000 shares of Packard. That was the first change in the account of any consequence. In April he bought 2,000 shares of Public Service of New Jersey. In May he sold 2,000 shares of Public Service of New Jersey, 1,000 shares of Packard, and 300 shares of U. G. I. stock so that at the end of May 1928 he was long 1,200 shares U. G. I. On June 8 he bought 1,000 shares of U. G. I., on June 11, 400 shares of General Motors, and on June 12, 600 shares of General Motors and 500 shares of Hudson. On July 2 he sold 1,000 shares of General Motors. On July 17 he bought 500 shares of General Motors. On August 9 he bought 500 shares of General Motors and on August 10, 500 shares of Hudson. On August 17, he sold 500 shares of General
32 Motors. On September 6 he bought 500 shares of National Power and Light, on September 10, 500 shares of Consolidated Gas and on September 14, 1,000 shares of Stanley. On September 15 he sold 500 shares of Hudson, on September 25, 500 shares of Hudson, and on September 26, 500 shares of National Power and Light. On September 27 he bought 1,000 shares of Electric Power and Light and 500 shares of Chrysler, and on September 28 he bought 500 shares of General Motors. On October 8 he bought 500 shares of General Motors and sold 500 shares of Chrysler. On October 19 he bought 500 shares of United States Steel and sold 1,000 shares of General Motors. On October 22 he sold 500 shares of U. G. I. On October 26 he bought 1,000 shares of Studebaker. During November he bought Victor Talking Machine, Sun Oil, Keith-Albee, Shubert, Pennsylvania Railroad, and Curtis stock and sold U. G. I. and Victor stock. On December 10 he sold 8,500 shares in all of Keith-Albee, Curtis, Consolidated Gas, Pennsylvania Railroad, Shubert, Stanley, Studebaker, Victor, and Electric Power and Light. He sold additional shares of General Motors, United States Steel, and Victor, and bought Victor, Chrysler, A. M. Byers, Packard, Curtis, and Kolster Radio stock, so that on December 31, 1928, he was long 1,200 shares of U. G. I., 200 shares of Kolster, and 100 shares each of United States Steel, General Motors, Victor, Chrysler, Packard, Curtis, Sun Oil, and A. M. Byers.

Decedent consulted me about these purchases and sales and during 1928 I many times advised him to sell everything he had. Decedent told me, however, that he was not willing to sell the 1,200 shares of U. G. I. stock which he had purchased in 1926 but he would fix a price at which he would sell the others. He would give instructions that when a stock reached a certain point going up to sell and if it dropped to a certain point to sell. He said he regarded the
33 1,200 shares of U. G. I. stock as an inheritance from his father. He had sentimental reasons in regard to it and was not interested in its real financial value and regarded it as a permanent investment.

On cross-examination the witness testified as follows:

Decedent never received any certificates. West & Company would send a memorandum with respect to each purchase and sale. He just gave an order to the broker buy or to sell so many shares and received the notice the following day that so many shares were bought or sold.

"Q. So far as you were concerned you were not selling any particular shares of the stock?

"A. Yes, so far as Mr. Turner was concerned, he was selling the 1,000 shares he purchased in 1928. It was never his intention to change his position with respect to this 1,200 shares he purchased in 1926.

"Q. Yes, but wasn't that only a mental thought on his part; did it make any difference whether he was selling the 1,200 shares purchased in 1926 or the 1,000 shares purchased in 1928—he did not have any of the certificates?

"A. So far as Mr. Turner was concerned and West & Company were concerned they knew his desires and feelings about the 1,200 shares of U. G. I. For myself I had discussed it with Mr. Carey of West & Company, and he knew Mr. Turner's feelings about that, the 1,200 shares."

I never knew in what form West & Company had title to the certificates of stock. They were not in the name of the decedent. The dividends that were declared were received by West & Company and credited to the decedent's account "but from the very beginning West & Company knew Mr. Turner's intentions, and knew he was keeping the first purchase of 1,200 shares."

34 Until this question was raised by the Government neither decedent nor I knew how West & Company handled these transactions. I went to West & Company two years after the transaction to find out from them a record of the certificates they had representing the original 1,200 shares. I expected they could tell me the number of certain certificates for 1,200 shares and for the first time learned that they could not. They told me that they cleared through a clearing house and always kept or had certificates for exactly the number of shares that all of their customers were long but they could not say that certain certificates or certain numbers were the decedent's. Both decedent and I thought that they had particular certificates which represented the 1,200 shares, the 500 shares, and the other 500 shares and the first we knew that was not so was after the agent had audited decedent's accounts.

"Q. You say that Mr. Turner regarded these shares purchased in 1926 as an inheritance from his father—in other words he had used the money I presume that he got from his father's estate to put up as margins for the purchase of these stocks in 1926?

"A. Yes, sir.

"Q. That would not as a matter of fact make any difference what 1,200 shares he regarded as inheritance from his father, whether

at the end of 1928 he still had 1,200 shares reserved in the margin account, so far as his intent was it would have been fulfilled by the holding of any of the shares that were purchased?

"A. No, sir, in Mr. Turner's mind he was so constituted that I know of many instances in our own contact—for instance, there was a certain piece of furniture that was not worth a dollar in his home,—he leased his home to a man, and when the man moved out that piece of furniture was not there, and it did not satisfy
35 him to return the value of the furniture. He wanted the particular piece of furniture, and it is in his own mind he had that certain thought that he wanted these particular 1,200 shares."

When we put in an order to sell we merely said to sell 500 shares. Decedent had in his own mind that it was the 500 shares of the 1,000 shares he had purchased in that year and Mr. Carey knew that decedent felt in his mind that he still had that 1,200 shares. Neither decedent nor I thought it necessary to say anything more, for Mr. Carey knew his position and realized decedent's desires were genuine, and decedent felt it unnecessary to tell him which 1,000 shares he sold.

"Q. It would make no particular difference, so far as he was concerned; he would still have 1,200 shares?

"A. According to his own idea it would make a material difference, for that 1,200 shares was a different transaction, not to be touched. In other words, it is like two lumps of sugar; they might be the same thing, but one lump might have a particular meaning, and while the second one would not have.

"Q. It was mere intention on his part, that is all it amounted to?

"A. Intention and his own way of bookkeeping, and keeping of the records in his own mind of what he had.

"Q. Outside of that it had no substance except what was in his own mind?

"A. Well, also this he knew at the times of the sale of his own gains and losses for the year, for I calculated them and those sales were made, calculated the stocks that were being sold were the stocks purchased in that year, for we made the calculation of what the expense was by way of gain or loss on the sale."

Very frankly we never dreamed of the possibility that they
36 would regard this as the sale of the earlier purchases. We got West & Company's statements and calculated all purchases and sales already made to determine whether he should sell more stock or not, and we gave no thought at all to the stock bought in 1926 because in his mind and in my mind what he sold was the very same stock that he had purchased in this particular year. About the middle of December 1928 we made as accurate a calculation as we could at that time of his gross income, and entered his deductions, and based the tax on his expenses and experience up to that time.

THOMAS MCDOUGAL, witness for the petitioner, testified as follows:

I am manager of the Turner Supply Company. Decedent was sick more or less from 1924 and was quite blind from 1928 on, and therefore I had to handle a great many of his personal affairs. I had complete knowledge of the marginal account in which U. G. I. was bought and sold. In most of our trips to the doctor we spent the time in a complete discussion of this account. From time to time I would have to get him quotations and check up on his holdings, and I conferred with him thoroughly once a week. I knew from many conversations with him about the sales of U. G. I. stock in 1928. He had a very definite idea in his own mind as to what stocks he was selling and what stocks he was keeping, and he often discussed with me the difference between his first 1,200 shares and the shares he subsequently bought. In all of my conversations with him he talked about the difference in these holdings.

"Q. Did he explain any distinction in his holdings?

"Mr. MORAWSKI. I object, Your Honor. This calls for hearsay testimony.

37 "The MEMBER. Objection overruled.

"Mr. MORAWSKI. We note an exception.

"The MEMBER. Exception noted.

"A. These conversations were all direct from Mr. Turner to me. I being manager of the Turner Supply Company was very much in close touch to Mr. Thompson, and this U. G. I. proposition in the beginning was discussed from time to time before Mr. Turner bought, and Mr. Thompson had a friend with the Gas Company, Mr. Shaddock, and Mr. Turner always asked him to get in touch with Mr. Shaddock and that was before he bought, and I know how deeply he went into the U. G. I. problem, and he always thought this U. G. I. was an investment proposition. Then when Mr. Massey came to live at Chester Club, Mr. Turner had a place in Elkton, and Mr. Massey visited with him, quite a good deal, and I used to go down there on Saturday after the day's work was over, and Mr. Turner always had work around the place, and the main part of the conversation was U. G. I.

"Q. In 1928 at the time these sales took place, did he then explain any distinction between this original 1,200 shares, and the other stock?

"A. Yes, sir; he did.

"Mr. MORAWSKI. I object to that question, Your Honor, on the ground that it calls for hearsay testimony.

"The MEMBER. Objection overruled.

"Mr. MORAWSKI. We note an exception.

"The MEMBER. Exception noted.

"A. Always the stock that he bought in 1928 he stated that he bought this stock to deal actively in. He suggested, or he talked to me that this U. G. I. stock that he bought that year was just the same

as any other stocks that he bought. He bought with the hopes of making a profit and selling them, but he never relinquished the
38 idea of this original 1,200 shares in all our conversations when we would go over at the end of the month his holdings he expressed that, and there was no doubt in my mind that it was very clear to him the difference between the two classes of the U. G. I. stock he held."

At this point witness identified a memorandum in decedent's handwriting made approximately in November 1928, which was admitted in evidence as exhibit no. 1 and pointed out that the third item from the bottom is the U. G. I. stock. On all of the others he has the word "sell" which indicates the number of shares he was willing to sell but on this there is a blank. The 1,200 shares of U. G. I. which he held at that time he did not have any price on or any intention of selling when he made this memorandum. I know this because he constantly made memoranda of this kind to check his holdings. I know that he did not intend to sell these 1,200 shares.

On cross-examination the witness testified as follows:

In those conversations with decedent he always separated these 1,200 shares and he never talked in any other way than that was the thought in his mind and those shares had nothing to do with the stock he subsequently bought and sold. When he bought these shares he did not actively operate in the market, and he did not actively operate until over a year afterwards and that was a different proposition. He then was sick and had arthritis and was away from his business and had all day to himself and he played the market. He bought and sold these other shares as a profitable pastime. I never saw any certificates of stock.

Approved, settled, and ordered filed this 23rd day of January 1933.

(S.) CHARLES P. SMITH,
Member, United States Board of Tax Appeals.

39 Before United States Board of Tax Appeals

Praecipe for transcript of record

Filed January 27, 1934

To the Clerk of the United States Board of Tax Appeals:

You are requested to prepare and transmit to the Clerk of the United States Circuit Court of Appeals for the Third Circuit a certified copy of the record in the above-entitled case, including therein copies of the following:

1. Docket entries.
2. Petition.
3. Answer.
4. Motion to amend petition and notation that same was granted (see transcript of hearing, page 5).

5. Suggestion of death and motion to substitute and order of April 27, 1932, granting same.
6. Order of September 23, 1932.
7. Order of October 4, 1932.
8. Findings of fact and opinion.
9. Decision.
10. Petition for review.
11. Statement of evidence.
12. This praecipe.

JAMES CRAIG PEACOCK,
Attorney for Petitioner.

Service of a copy accepted and praecipe agreed to.

E. BARRETT PRETTYMAN,
General Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

40 [Clerk's certificate to foregoing transcript omitted in printing.]

41 In United States Circuit Court of Appeals for the Third Circuit

Stipulation as to substitution

Filed March 5, 1934

Whereas, pending the hearing of this case before the Board of Tax Appeals the taxpayer, Richard B. Turner, died on February 21, 1932; and

Whereas, on February 25, 1932, James L. Rankin duly qualified as Executor for the said Estate of Richard B. Turner, Deceased, and is now, and at all times has been, the duly qualified and acting executor of said estate; and

Whereas, on October 4, 1932, the Board of Tax Appeals substituted as petitioner "The Estate of Richard B. Turner, Deceased"; and

Whereas, on October 17, 1932, the Board of Tax Appeals entered a decision against the Estate of Richard B. Turner, Deceased; and

Whereas, on January 6, 1933, the "Estate of Richard B. Turner, Deceased", filed a petition for review with the Court of Appeals of the District of Columbia and at the same time filed a petition for review with the Circuit Court of Appeals for the Third Circuit; and

Whereas, on January 2, 1934, the Court of Appeals of the District of Columbia dismissed said petition filed with that court, on the ground that it was without jurisdiction; and

42 Whereas, James L. Rankin, executor of the Estate of Richard B. Turner, Deceased, has filed with the Circuit Court of Appeals for the Third Circuit a motion to substitute himself for said

"Estate of Richard B. Turner, Deceased", as petitioner, notwithstanding that the time for filing a new petition has expired; and

Whereas, the parties hereto desire that the case be decided on its merits without further controversy over technical questions:

Now, therefore, in consideration of the respondent acquiescing in the pending motion for the substitution of the said James L. Rankin, executor, as petitioner, the said James L. Rankin agrees, for himself in his capacity as such executor, and for the Estate of Richard B. Turner, deceased, that in the event the Circuit Court of Appeals for the Third Circuit entertains jurisdiction of this proceeding and the decision below is finally affirmed on its merits, then, unless collection has then been made, the tax involved in this proceeding will be paid promptly and neither party shall hereafter raise any question as to proper or necessary parties in this case.

JAMES L. RANKIN,
Executor of the Estate of Richard B. Turner, Deceased.

MARCH 5th, 1934.

J. P. JACKSON,
Attorney for the Respondent.
JAMES CRAIG PEACOCK,
JOHN W. TOWNSEND,
Attorneys for James L. Rankin as Executor of the Estate of Richard B. Turner, Deceased.

43 United States Circuit Court of Appeals for the Third Circuit

No. 5424. March term, 1934

ESTATE OF RICHARD B. TURNER, DECEASED, PETITIONER
vs.
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Upon consideration of the motion of petitioner filed herein on the 26th day of February 1934 and the consent thereto of counsel for the respondent, it is by the court, this 5th day of March 1934,

Ordered, adjudged, and decreed that James L. Rankin, as executor of the estate of Richard B. Turner, deceased, be, and he hereby is, substituted as party petitioner herein and the caption of this case shall be corrected accordingly.

PER CURIAM,
BUFFINGTON,
Circuit Judge.

We consent:

JNO. W. TOWNSEND,
Attorney for petitioner.
J. P. JACKSON,
Attorney for respondent.

44 United States Circuit Court of Appeals for the Third Circuit

No. 5424

ESTATE OF RICHARD B. TURNER, DECEASED, PETITIONER
vs.
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Upon motion of the petitioner, expressly consented to by Guy T. Helvering, Commissioner of Internal Revenue, it is hereby ordered that said Guy T. Helvering, as such officer, be, and he hereby is, substituted for David Burnet, former Commissioner of Internal Revenue, and that this proceeding be so continued and maintained.

Dated: May 2, 1934.

J. W. THOMPSON,
U. S. Circuit Judge.

(Endorsements:) Order substituting Guy T. Helvering as Commissioner, etc. Rec'd & filed May 2, 1934. Wm. P. Rowland, clerk.

45 United States Circuit Court of Appeals for the Third Circuit

No. 5424. March term, 1934

JAMES L. RANKIN, EXR. OF THE ESTATE OF RICHARD B. TURNER, Deceased, petitioner
vs.
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

And afterward, to wit, the 2d day of May 1934, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable Victor B. Woolley, Honorable J. Warren Davis, and Honorable J. Whitaker Thompson, Circuit Judges, and the court not being fully advised in the premises, takes further time for the consideration thereof.

And afterward, to wit, on the 18th day of September, 1934, come the parties aforesaid by their counsel aforesaid, and the court, now being fully advised in the premises, renders the following decision:

46 United States Circuit Court of Appeals for the Third Circuit

No. 5424. March term, 1934

JAMES L. RANKIN, EXECUTOR OF THE ESTATE OF RICHARD B. TURNER, Deceased, petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On petition for review from the United States Board of Tax Appeals

Opinion

Filed September 18, 1934

Before WOOLLEY, DAVIS, and THOMPSON, Circuit Judges

WOOLLEY, *Circuit Judge:*.

The Commissioner of Internal Revenue assessed a deficiency tax against Richard B. Turner for the tax year 1928. Turner petitioned the United States Board of Tax Appeals for a redetermination of the deficiency. His executor is here on petition to review the order of that tribunal sustaining the tax.

This case, like that of Snyder v. Commissioner, — Fed. (2d) —, arose out of confusion (this time by the Commissioner) in the terms "shares" and "certificates" in transactions of sale of stock on margin as affected by section 113 (a) of the Revenue Act of 1928 making cost the basis of taxation and by the administrative
47 regulation (article 58 of regulations 74) providing that:

"When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots can not be determined, the stock sold shall be charged against the earliest purchases of such stock. * * *"

This is the familiar "First in, first out" rule and is to be applied in this case (as it was in both Snyder cases, 54 Fed. (2d) 57 and — Fed. (2d) —) according as the "shares" sold have or have not been identified as shares purchased in certain lots, not according to identification of certificates for the shares.

Identification being a matter of fact, the facts on that issue are these:

Early in 1926, Turner purchased on marginal account with a Philadelphia broker 1,200 shares of the stock of United Gas Improvement Company, known on the "street" as U. G. I. For nearly two years he had no further marginal transactions in this or any other stock. At the beginning of 1928 his marginal account was long 1,500 shares of U. G. I., the additional 300 shares representing a twenty-five per cent stock dividend credited to him late in 1926.

In 1928 Turner began playing the market. Included in many marginal transactions, not of present concern, he bought 1,000 shares of U. G. I. and at one time sold 300 shares, at another 500 shares, and at still another 500 shares of that stock. By the end of 1928 (the tax year) Turner's account was long 1,200 shares of U. G. I., the precise number he bought in 1926. The Commissioner in determining a deficiency tax applied the "First in, first out" rule on findings that of the 1,300 shares which the petitioner sold in 1928 (the tax year) 1,040 shares were out of the original 1,200 purchased in 1926 and 260 were a part of the stock dividend he received in that year, and that the total basis for computing gain or loss should thus be reduced from the taxpayer's figures (which he
48 reckoned, in part, on the sale of the 1,000 shares he had bought in the tax year) to $99,735, the cost of 1,300 shares first acquired by purchase and stock dividend, and the taxable profit should be correspondingly increased from $25,933.50 to $92,864, disclosing liability for a deficiency tax in the sum of $11,173.05.

If this were all there was in the case the deficiency tax and the theory of its assessment under the "First in, first out" rule would, without doubt, be right. But if there was "something else" in the case, as we said in Snyder v. Commissioner, 54 Fed. (2d) 57, 58, and it has to do with identification of the shares of U. G. I. sold in 1928 on whose gain the tax was levied, the assessment is open to question. There was something else; and it bore directly on identification of the shares and therefore on the application of the rule. The evidence on this point is substantially as follows:

Early in 1926 Turner received $20,000 in bonds as a distribution of his father's estate. He did not believe in bonds as an investment and desired to change his inheritance into stocks. Being in ill health, later becoming blind, he called in his attorney and directed him to have an account opened with a Philadelphia broker, have the broker sell the bonds and with the proceeds purchase on margin 1,200 shares of United Gas Improvement Company stock. This was done, the debit balance later being increased to 1,500 shares by the stock dividend, for all of which the broker held "street certificates"; that is, certificates in the names of other persons, endorsed in blank.

The evidence shows conclusively that Turner was sentimental about keeping the original 1,200 shares as an inheritance from his father; that his "intention" was to retain as an investment the shares originally purchased and sell in speculation the shares more recently acquired, which clearly was not enough to take the case out of
49 the rule. Snyder v. Commissioner, 54 Fed. (2d) 57; Snyder v. Commissioner, — Fed. (2d) —; Horner v. Commissioner, — Fed. (2d) —; Commissioner v. Merchants and Manufacturers Fire Insurance Company, — Fed. (2d) —; and that he made repeated declarations of that intention to his associates which, likewise was not enough. Skinner v. Commissioner, 45 Fed. (2d) 568.

Evidence of intention of the owner of shares in transactions of purchase and sale though not dispositive of the question of identifi-

cation has, nevertheless, a bearing on the ultimate question, what the owner did about it. Commissioner v. Merchants and Manufacturers Fire Insurance Company, — Fed. (2d) —; Howbert v. Penrose, 38 Fed. (2d) 577. What Turner did in this case, acting and speaking through his attorney, was to communicate to his broker his intention to hold for investment the shares of U. G. I. he originally purchased. His decisions to sell like shares later purchased were reached on that basis; his books and records were kept on that basis; and, accordingly, his income-tax return was made on that basis. The Commissioner, the Board of Tax Appeals affirming him, ignored this action of the petitioner on the theory that the U. G. I. stock, which from time to time he purchased on margin, and later sold, could be identified only by certificates; that as no certificates for shares were ever in his name, the shares sold could not be identified as shares purchased in any particular lot or at any particular time or price and, accordingly, charged the shares sold against those earliest purchased within the "First in, first out" rule.

That was error. What was bought and sold were shares, not certificates (discussed in Snyder v. Commissioner, — Fed. (2d) —; Meyer on The Law of Stock Brokers and Stock Exchanges, sec. 42).

Shares as distinguished from certificates are property subject
50 to conversion and capable of identification. We think the petitioner's communication to his broker of his intention to hold the 1,200 shares first purchased as an investment was in effect an order to his broker not to sell those shares, and when, two years later, he ordered the broker to make two sales in lots of 500 shares each, they were, conformably with the original instructions, the 1,000 shares last purchased. The petitioner's instructions excluding from sale the shares first purchased were in effect an identification of the shares later sold as those last purchased.

While the petitioner, in identifying his shares, might have been more specific in his instructions to his broker, those he gave stand uncontradicted; indeed, they have not been questioned. We think they were enough to take the case out of the rule and that, in consequence, the deficiency tax in issue is invalid to the extent that it is based on gains in sales of U. G. I. shares reckoned on the purchase price of the original 1,200 shares.

The order of the Board of Tax Appeals sustaining the deficiency tax assessed by the Commissioner is, for the reasons and to the extent indicated in this opinion, reversed.

A true copy.

Teste:

Clerk of the United States Circuit Court of Appeals for the Third Circuit.

51 United States Circuit Court of Appeals for the Third Circuit

No. 5424. March term, 1934

JAMES L. RANKIN, EXR. OF THE ESTATE OF RICHARD B. TURNER, Deceased, petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this court that the order or decree of the said Board of Tax Appeals in this cause be, and the same is hereby, reversed to the extend indicated in the opinion of this court, with direction to the said Board of Tax Appeals to enter a new order in conformity with said opinion.

Philadelphia, September 18, 1934.

VICTOR B. WOOLLEY,
Circuit Judge.

(Endorsements:) Order reversing decree. Rec'd & filed Sept. 18, 1934. Wm. P. Rowland, clerk.

52 UNITED STATES OF AMERICA,
Eastern District of Pennsylvania,
Third Judicial Circuit, sct.:

I, Wm. P. Rowland, clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original transcript of record and proceedings in this court in the case of James L. Rankin, Exr. Est. Richard B. Turner, Deceased, petitioner, vs. Commissioner of Internal Revenue, respondent, No. 5424, on file, and now remaining among the records of the said court, in my office.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of the said court, at Philadelphia, this 10th day of December, in the year of our Lord one thousand nine hundred and thirty-four and of the independence of the United States the one hundred and fifty-ninth.

WM. P. ROWLAND,
Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

[SEAL.]

53 Supreme Court of the United States

Order allowing certiorari

Filed February 4, 1935

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Endorsement on cover:) File no. 39,210. U. S. Circuit Court of Appeals, Third Circuit. Term no. 582. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, vs. James L. Rankin, Executor of the Estate of Richard B. Turner, Deceased. Petition for a writ of certiorari and exhibit thereto. Filed December 15, 1934. File no. 582 O. T. 1934.

U. S. GOVERNMENT PRINTING OFFICE: 1935

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute and regulations involved	2
Statement	3
Specification of errors to be urged	4
Reasons for granting the writ	5

CITATIONS

Cases:	
Champion v. *Commissioner*, 27 B. T. A. 1312	9
Cleveland Trust Co. v. *Commissioner*, 24 B. T. A. 132	9
Cole v. *Helburn*, 4 F. Supp. 230	8
Commissioner v. *Merchants' & Mfrs'. F. Ins. Co.*, 72 F. (2d) 408	6
Duncan v. *Johnston & Co.*, 3 F. (2d) 422, certiorari denied, 267 U. S. 600	9
Finlay v. *Commissioner*, 17 B. T. A. 828	9
Hedrick v. *Commissioner*, 24 B. T. A. 444	8
Horner v. *Commissioner*, 72 F. (2d) 407	6
Howbert v. *Penrose*, 38 F. (2d) 577	6, 8
Jenks v. *Commissioner*, 22 B. T. A. 910	8
Kelchner v. *Commissioner*, 31 B. T. A. 262	9
Leng v. *Commissioner*, 22 B. T. A. 149	8
Mickler Holding Co. v. *Commissioner*, 29 B. T. A. 300	9
Richardson v. *Shaw*, 209 U. S. 365	9
Scanlon v. *Commissioner*, 21 B. T. A. 1120	9
Seelye v. *Commissioner*, 29 B. T. A. 695	9
Sexton v. *Kessler*, 225 U. S. 90	6
Skinner v. *Eaton*, 45 F. (2d) 568, certiorari denied, 283 U. S. 837	5, 6, 7
Snyder v. *Commissioner*, 54 F. (2d) 57	6
Snyder v. *Commissioner*, decided September 18, 1934, 73 F. (2d) 5	6, 9
Stryker v. *Commissioner*, 21 B. T. A. 561	8
Towne v. *M'Elligott*, 274 Fed. 960	8
Statutes:	
Revenue Act of 1928, c. 852, 45 Stat. 791, 818, sec. 113	2
Treasury	
Regulations 33 (Revised), Art. 4, Par. 60	5
Regulations 45, Art. 39	5
Regulations 62, Art. 39	5
Regulations 65, Art. 39	5
Regulations 69, Art. 39	5
Regulations 74, Art. 58	2
Regulations 77, Art. 58	5

102495—34

In the Supreme Court of the United States

OCTOBER TERM, 1934

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

JAMES L. RANKIN, EXECUTOR OF THE ESTATE OF Richard B. Turner, deceased

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Third Circuit, entered in the above cause on September 18, 1934, reversing the decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The findings of fact and opinion of the Board of Tax Appeals (R. 15–20) are reported in 26 B. T. A. 1204. The opinion of the Circuit Court of Appeals is reported in 73 F. (2d) 9.

JURISDICTION

The decision of the Circuit Court of Appeals reversing the Board of Tax Appeals was rendered September 18, 1934. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether shares of stock held on margin are capable of identification so that a taxpayer selling part of his holdings may select, as his basis for determining gain or loss, the cost of any particular lot.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791, 818:

> SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.
>
> (a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *.

Treasury Regulations 74:

> ART. 58. *Sale of stock and rights.*—When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock. * * *

STATEMENT

This is a proceeding for the redetermination of a deficiency in income taxes for the year 1928 in the sum of $11,173.05 asserted against one Richard B. Turner, who died in 1932, during the pendency of these proceedings, James L. Rankin, his executor, being substituted (R. 13–14, 41–42). The facts as found by the Board of Tax Appeals may be summarized as follows (R. 16–18):

Early in 1926 Turner purchased on marginal account with a Philadelphia broker 1,200 shares of United Gas and Improvement Company stock. For nearly two years he had no further marginal transactions. At the beginning of 1928 his marginal account was long 1,500 shares of U. G. I., the additional 300 shares representing a 25-percent stock dividend credited to him late in 1926.

In 1928 Turner began playing the market. Included in many marginal transactions he bought 1,000 shares of U. G. I., and at one time sold 300 shares, at another 500 shares, and at still another 500 shares of that stock. By the end of 1928 (the tax year) Turner's account was long 1,200 shares of U. G. I., the same number he bought in 1926.

Turner always intended to retain the ownership on margin of 1,200 shares of U. G. I., since he had faith in the company and desired to hold that in lieu of certain bonds which he had received from the estate of his father. In giving orders to his broker to sell the 1,300 shares in 1928 he did not

specify any particular shares to be sold, but an employee of the broker understood that Turner desired to retain 1,200 shares to take the place of the bonds which he had received from his father. The decedent had made it plain to his associates that the 1,200 shares were in the nature of a permanent commitment on his part.

In computing the gain from the sale of the 1,300 shares in 1928 the Commissioner in accordance with Article 58 of Regulations 74, *supra,* applied the sales against the first purchases of the stock. The Board of Tax Appeals sustained this action (R. 18–20), but the Circuit Court of Appeals reversed, holding that Turner's communication to his broker of his intention to hold the 1,200 shares first purchased as an investment was in effect an order to his broker not to sell those shares. The court decided that these instructions were in effect an identification of the shares later sold as those last purchased.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that, while certificates of stock cannot be identified by a holder on margin, nevertheless shares of stock so held are capable of identification.

2. In holding that the communication to the stock broker of an intention to hold the first shares purchased on margin was an identification of the

shares sold within the meaning of Article 58, Regulations 74.

3. In holding that Article 58, Regulations 74, had no application to this case.

4. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision below conflicts in principle with the decision of the Circuit Court of Appeals for the Second Circuit in *Skinner* v. *Eaton*, 45 F. (2d) 568, certiorari denied, 283 U. S. 837. The distinction attempted by the court below is unsound.

In this case the decedent held shares of stock on margin, acquired at different times and at various prices. During the taxable year he sold part of the shares, and the question is what cost basis is to be used.

Article 58 of Regulations 74, *supra*, provides that when shares of stock are sold from lots purchased at different times and at different prices and the identity of the lots cannot be determined, the stock shall be matched against the earliest purchases. This regulation, commonly known as the "first in, first out" rule, has been in effect under all the Revenue Acts [1] and has received legislative and

[1] Article 4, Paragraph 60, Regulations 33 (Revised), promulgated under the 1916 Act; Article 39, Regulations 45, 62, 65, and 69, promulgated under the Revenue Acts of 1918, 1921, 1924, and 1926, respectively; and Article 58 of Regulations 74 and 77, promulgated under the Revenue Acts of 1928 and 1932, respectively.

judicial approval. *Skinner* v. *Eaton, supra; Howbert* v. *Penrose,* 38 F. (2d) 577 (C. C. A. 10th). The court below has sustained and applied the rule in similar cases. *Snyder* v. *Commissioner,* 54 F. (2d) 57; *Snyder* v. *Commissioner,* decided September 18, 1934, 73 F. (2d) 5; *Horner* v. *Commissioner,* 72 F. (2d) 407; *Commissioner* v. *Merchants' & Mfrs'. F. Ins. Co.,* 72 F. (2d) 408. As pointed out by the court below in the first *Snyder* case, *supra,* the rule was apparently adopted with particular reference to marginal transactions where identification is impossible.

The mechanics of a marginal transaction is a matter of common knowledge. Each customer is merely charged on the broker's books with the number of shares ordered. No entry is made on the books of the serial numbers of the certificates. The certificates are not issued in the name of the customer, but in the name of the broker or street names. The broker makes no allocation of the particular certificates to any particular client, nor are the certificates earmarked in any way. All stock of the same kind is commingled and held by the broker for the common benefit of all dealing in that particular stock. Marginal stock held by the broker is, therefore, a "fungible mass." See *Sexton* v. *Kessler,* 225 U. S. 90, 98. Particular shares are not identifiable, because the common fund is the common property of all dealing in that stock and this common fund is in a constant state of flux.

The regulation was designed to meet just such a situation and provides for a cost basis in these transactions where identification is impossible.

Although approving of the regulation, the court below held that it has no application here because the decedent identified the shares sold as the latest shares purchased. The decedent's first purchase of stock was made with funds derived from his father's estate, and he intended to keep that stock intact as an investment. He so notified his broker. The court below held that decedent's communication to his broker of his intention to retain the first purchases was identification sufficient to take the case out of the rule, despite the fact that the broker could not say what shares had been sold (R. 34). Thus, the court allows a mere declaration of intention to take the place of the factual identification required by the regulation. In so holding the decision below conflicts in principle with *Skinner* v. *Eaton, supra,* where the Circuit Court of Appeals for the Second Circuit said (p. 570):

> In support of their claim, the appellants * * * rely upon the testimony of the associates of the taxpayer, who said that the decedent told them he intended to retain his original holdings in the corporation, and that he intended to sell certain stock purchased for return. These statements are alleged to have been made in 1914 and 1915. The declarations of a taxpayer as to his intention to sell the more recently purchased

> stock and to retain his original holdings, made orally, are insufficient to change the result. They indicate merely a purpose which he may not have adhered to. They in no way marked the particular shares of stock here under consideration, the identity of which the trial judge has found to have been lost.

The decision is also inconsistent with the court's earlier decisions referred to above, where it had held that an intent or purely mental condition falls short of evidential identification.[2] See also *Howbert* v. *Penrose, supra,* where it was held (p. 578) that intent of the seller "is some evidence as to what was done, but not conclusive."

The decision below is also opposed to the decisions of the District Courts in *Towne* v. *M'Elligott,* 274 Fed. 960 (S. D. N. Y.), and *Cole* v. *Helburn,* 4 F. Supp. 230 (W. D. Ky.), and to a long line of Board of Tax Appeals decisions. *Leng* v. *Commissioner,* 22 B. T. A. 149; *Jenks* v. *Commissioner,* 22 B. T. A. 910; *Hedrick* v. *Commissioner,* 24 B. T. A. 444; *Stryker* v. *Commissioner,* 21 B. T. A. 561;

[2] The court attempted to reconcile its earlier position by stating that mere intent, even though communicated to the taxpayer's associates, is not enough. It held that here there was "something more"; namely, the communication of the intent to the broker, which was sufficient to take the case out of the rule. However, we submit that where it is impossible even for the broker to identify (R. 34) a declaration of intent made to the broker is not different from a similar declaration made to the taxpayer's associates as in the *Skinner* case, *supra.*

Scanlon v. *Commissioner*, 21 B. T. A. 1120; *Cleveland Trust Co.* v. *Commissioner*, 24 B. T. A. 132; *Finlay* v. *Commissioner*, 17 B. T. A. 828; *Champion* v. *Commissioner*, 27 B. T. A. 1312; *Mickler Holding Co.* v. *Commissioner*, 29 B. T. A. 300; *Kelchner* v. *Commissioner*, 31 B. T. A. 262; *Seelye* v. *Commissioner*, 29 B. T. A. 695.

The court below sought to make a distinction between a sale of certificates and a sale of shares. See also the second *Snyder case, supra.* It recognizes that in marginal transactions certificates cannot be identified, but holds that shares, as distinguished from certificates, are capable of identification. This so-called distinction does not exist. If the shares are capable of identification, it is only by means of certificates or some other evidence of ownership. Shares of stock as such have "no earmark which distinguishes one share from another." *Richardson* v. *Shaw*, 209 U. S. 365, 379; *Duncan* v. *Johnston & Co.*, 3 F. (2d) 422 (C. C. A. 6th). Where, as here, shares bought on margin are not represented by identifiable certificates, it is utterly impossible to identify them, and the need for a rule such as is contained in the regulation is apparent. Since the broker cannot identify the certificates, it is not apparent how the communication of the taxpayer's intention to the broker can add anything to the intention itself. The court below concedes that the latter is insufficient.

2. The decision below deals with a class of transactions in which a large number of taxpayers

engage, and it injects an element of uncertainty in the administration of the law. Marginal transactions are of common and frequent occurrence. A number of cases involving the application of the regulation to these transactions have already arisen, as is evidenced by the decisions referred to above. The Treasury Department advises that a large number of cases of this character are now pending in the Bureau. Undoubtedly similar cases will continue to arise in the future. It is important in the administration of the revenue that the proper method of computing gains and losses on this type of transaction be settled. In holding that shares of stock may be identified, even though the certificates are admittedly unidentifiable, and in holding that a mere declaration of intent made under the circumstances here present is sufficient identification, the decision below deprives the regulation of its effectiveness in the field of its most common application—that is, to marginal transactions. If permitted to stand, the decision below will create considerable confusion and doubt as to the proper rules to be applied in these cases. It is important, therefore, that this Court pass upon this case and establish rules to guide the Government and taxpayers in future cases of this character.

Wherefore, it is respectfully prayed that this petition be granted.

J. CRAWFORD BIGGS,
Solicitor General.

DECEMBER 1934.

U. S. GOVERNMENT PRINTING OFFICE, 1934

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statute and regulations involved	2
Statement	3
Specification of errors to be urged	5
Summary of argument	5
Argument:	
I. The taxpayer failed to identify the various lots of stock purchased by him on margin, hence it was proper to charge the first sales against the first purchases	7
II. The regulation is valid	21
Conclusion	30

CITATIONS

Cases:

Allen v. *Dubois*, 117 Mich. 115	18
Allen v. *United States*, 150 U. S. 551	24
Atlantic Coast Line v. *Riverside Mills*, 219 U. S. 186	24
Bailey v. *Alabama*, 219 U. S. 219	23, 27
Burnet v. *Brooks*, 288 U. S. 378	17
Burnet v. *Houston*, 283 U. S. 223	29
Burrall v. *Bushwick Railroad Co.*, 75 N. Y. 211	16
Byrne, In re, 32 F. (2d) 189, certiorari denied, *sub nom. Mohr* v. *Bielaski*, 280 U. S. 557	18
Callanan v. *Hurley*, 93 U. S. 387	24
Caswell v. *Putnam*, 120 N. Y. 153	16
City of Chicago v. *Sturges*, 222 U. S. 313	24
Clayton's Case, 1 Merivale 572	26
Clemmons v. *Commissioner*, 54 F. (2d) 209	12
Cleveland Trust Co. v. *Commissioner*, 24 B. T. A. 132	14
Cockrill v. *California*, 268 U. S. 258	27
Cohan v. *Commissioner*, 39 F. (2d) 540	23
Cole v. *Helburn*, 4 F. Supp. 230	11, 18
Commissioner v. *Merchants' & Mfrs.' F. Ins. Co.*, 72 F. (2d) 408	9, 14, 18
Cunningham v. *Brown*, 265 U. S. 1	26
DeGanay v. *Lederer*, 250 U. S. 376	17
Denton v. *Gurnett & Co.*, 69 F. (2d) 750	18
Disconto-Gesellschaft v. *U. S. Steel Co.*, 267 U. S. 22	17

Cases—Continued	Page
Douglas v. *Edwards*, 298 Fed. 229, reversed on other grounds, 269 U. S. 204	25
Duel v. *Hollins*, 241 U. S. 523	20
Duncan v. *Jaudon*, 15 Wall. 165	17
Duncan v. *Johnston & Co.*, 3 F. (2d) 422, certiorari denied, 267 U. S. 600	16
Empire State Surety Co. v. *Carroll County*, 194 Fed. 593	26
Ennis, In re, 187 Fed. 728	19
Everard's Breweries v. *Day*, 265 U. S. 545	25
Finlay v. *Commissioner*, 17 B. T. A. 828	14
First Nat. Bank of Boston v. *Commissioner*, 63 F. (2d) 685	17
Gorman v. *Littlefield*, 220 U. S. 19	20
Graves v. *Minnesota*, 272 U. S. 425	29
Hagar v. *Reclamation District No. 108*, 111 U. S. 701	21
Harder v. *Irwin*, 285 Fed. 402	25
Hedrick v. *Commissioner*, 24 B. T. A. 444	14
Heiner v. *Donnan*, 285 U. S. 312	23, 27
Helvering v. *Canfield*, 291 U. S. 163	25
Hewitt v. *Hayes*, 205 Mass. 356	26
Holland v. *State*, 161 Ga. 492	24
Horner v. *Commissioner*, 72 F. (2d) 407	9, 14
Howbert v. *Penrose*, 38 F. (2d) 577	9, 13, 18
Hubbell v. *Drexel & Co.* 11 Fed. 115	16
Hylton v. *United States*, 3 Dall. 171	29
Jenks v. *Commissioner*, 22 B. T. A. 910	14
Kelchner v. *Commissioner*, 31 B. T. A. 262	14
Legal Tender Cases, 12 Wall. 457	29
Leland v. *Commissioner*, 50 F. (2d) 523, certiorari denied, 284 U. S. 656	25
Leng v. *Commissioner*, 22 B. T. A. 149	13
Louisville Railroad Co. v. *Letson*, 2 How. 497	24
Manley v. *Georgia*, 279 U. S. 1	23, 27
Mason v. *Routzahn*, 8 F. (2d) 56, reversed, 13 F. (2d) 702, reversed, 275 U. S. 175	25
McAllister v. *Kuhn*, 96 U. S. 87	17
M'Intyre, T. A., & Co., In re, 181 Fed. 955	19
Mickler Holding Co. v. *Commissioner*, 29 B. T. A. 300	14
Mobile, J. & K. C. R. R. v. *Turnipseed*, 219 U. S. 35	21, 27
Muller v. *Dows*, 94 U. S. 444	24
National Bank v. *Insurance Co.*, 104 U. S. 54	18
National City Bank v. *Hotchkiss*, 231 U. S. 50	18
Orient Insurance Co. v. *Daggs*, 172 U. S. 557	23
Pierson, J. F., Jr., & Co., In re, 225 Fed. 889, affirmed, 233 Fed. 519	19, 20
Reaves v. *Ainsworth*, 219 U. S. 296	21
Richardson v. *Shaw*, 209 U. S. 365	16, 20
Scanlon v. *Commissioner*, 21 B. T. A. 1120	14

Cases—Continued

	Page
Schuyler v. *Littlefield*, 232 U. S. 707	18
Seelye v. *Commissioner*, 29 B. T. A. 695	14
Sexton v. *American Trust*, 45 F. (2d) 372	20
Sexton v. *Kessler*, 225 U. S. 90	10
Skinner v. *Eaton*, 45 F. (2d) 568, affirming 34 F. (2d) 575, certiorari denied, 283 U. S. 837	8, 9, 12, 14, 15
Skowhegan Bank v. *Cutler*, 52 Me. 509	16
Snyder v. *Commissioner*, decided September 18, 1934, 73 F. (2d) 5	9, 14, 15
Snyder v. *Commissioner*, 54 F. (2d) 57	9, 10, 14
St. Louis & S. F. R. R. v. *Spiller*, 274 U. S. 304	18
Stryker v. *Commissioner*, 21 B. T. A. 561	14
Towne v. *McElligott*, 274 Fed. 960	8, 11, 16, 26
Webb v. *Den*, 17 How. 576	24
Weiss v. *Stearn*, 265 U. S. 242	12
Whitney v. *California*, 274 U. S. 357	29
Wilson, J. C., & Co., In re, 252 Fed. 631	19
Yee Hem v. *United States*, 268 U. S. 178	27

Statutes:

Revised Statutes, Sec. 3207 (U. S. C. App., Title 26, Sec. 136)	25
Revenue Act of 1916, c. 463, 39 Stat. 756, Sec. 31	25
Revenue Act of 1918, c. 18, 40 Stat. 1057, Sec. 201	25
Revenue Act of 1928, c. 852, 45 Stat. 791:	
Sec. 111	2
Sec. 112	2
Sec. 113	3

Miscellaneous:

2 Chamberlayne on Evidence:	
Sec. 1086	24
Sec. 1087	24
Sec. 1159	24
Treasury Regulations 33 (Revised), Art. 4, Par. 60	8
Treasury Regulations 45, Art. 39	8
Treasury Regulations 62, Art. 39	8
Treasury Regulations 65, Art. 39	8
Treasury Regulations 69, Art. 39	8
Treasury Regulations 74, Art. 58	3, 9
Treasury Regulations 77, Art. 58	9
5 Wigmore on Evidence (2d Ed.), Sec. 2492	24

In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 582

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

JAMES L. RANKIN, EXECUTOR OF THE ESTATE OF RICHARD B. TURNER, deceased

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and opinion of the Board of Tax Appeals (R. 8–11) are reported in 26 B. T. A. 1204. The opinion of the Circuit Court of Appeals (R. 25–27) is reported in 73 F. (2d) 9.

JURISDICTION

The judgment of the Circuit Court of Appeals reversing the Board of Tax Appeals was entered

September 18, 1934. (R. 28.) The petition for a writ of certiorari was filed December 15, 1934, and was granted February 4, 1935. (R. 29.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether shares of stock held on margin are capable of identification so that a taxpayer selling part of his holdings may select, as his basis for determinitg gain or loss, the cost of any particular lot.

2. Whether Article 58, Regulations 74, is valid.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791, 815, 816, 818:

> SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.
>
> (a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.
>
> * * * * *
>
> SEC. 112. RECOGNITION OF GAIN OF LOSS.
>
> (a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, * * *.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *.

Treasury Regulations 74:

ART. 58. *Sale of stock and rights.*—When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock. * * *

STATEMENT

This is a proceeding for the redetermination of a deficiency in income taxes for the year 1928 in the sum of $11,173.05, asserted against one Richard B. Turner, who died in 1932, during the pendency of these proceedings, James L. Rankin, his executor, being substituted. (R. 6–7, 22–23.) The facts as found by the Board of Tax Appeals may be summarized as follows (R. 8–10):

Early in 1926, Turner (hereinafter called the taxpayer) purchased on marginal account with a Philadelphia broker 1,200 shares of United Gas Improvement Company stock. For nearly two years he had no further marginal transactions. At the beginning of 1928 his marginal account was long 1,500 shares of U. G. I., the additional 300

shares representing a 25 percent stock dividend credited to him late in 1926.

In 1928 the taxpayer began playing the market. Among many marginal transactions he bought 1,000 shares of U. G. I., and at one time sold 300 shares, at another 500 shares, and at still another 500 shares of that stock. By the end of 1928 (the tax year) the taxpayer's account was long 1,200 shares of U. G. I., the same number as he had bought in 1926.

The taxpayer always intended to retain the ownership on margin of 1,200 shares of U. G. I., since he had faith in the company and desired to hold them in lieu of certain bonds which he had received from the estate of his father. In giving orders to his broker to sell the 1,300 shares in 1928 he did not specify any particular shares to be sold, but an employee of the broker understood that the taxpayer desired to retain 1,200 shares to take the place of the bonds which he had received from his father. The taxpayer had made it plain to his associates that the 1,200 shares were in the nature of a permanent commitment on his part.

In computing the gain from the sale of the 1,300 shares in 1928 the Commissioner in accordance with Article 58 of Regulations 74, *supra,* applied the sales against the first purchases of the stock. The Board of Tax Appeals sustained this action (R. 10–11), but the Circuit Court of Appeals reversed, holding that Turner's communication to

his broker of his intention to hold the 1,200 shares first purchased as an investment was in effect an order to his broker not to sell those shares. The court decided that these instructions were in effect an identification of the shares later sold as those last purchased. (R. 26–27.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that, while certificates of stock cannot be identified by a holder on margin, nevertheless shares of stock so held are capable of identification.

2. In holding that the communication to the stockbroker of an intention to hold the first shares purchased on margin was an identification of the shares sold within the meaning of Article 58, Regulations 74.

3. In holding that Article 58, Regulations 74, had no application to this case.

4. In reversing the Board of Tax Appeals.

SUMMARY OF ARGUMENT

I

Shares of stock as such have no earmark which distinguishes one share from another. It is only by tracing shares through identifiable certificates or similar evidences of ownership that one lot of stock can be distinguished from another. But in a marginal transaction the purchases and sales are

not represented by identifiable certificates and it is usually impossible for either the broker or the custom to identify the stock sold. Identification was impossible in this case. It was, therefore, proper for the Commissioner to apply the sales against the earliest purchases in accordance with Article 58, Regulations 74, *supra*.

The taxpayer's direction to his broker to sell the last shares purchased did not identify the stock sold. Mere intent to sell certain stock is not an identification of what was sold. Nor does a declaration of that intent amount to identification. It follows that a mere communication of intent to the broker, where the broker himself cannot identify, is likewise no identification.

II

The regulation does not deprive the taxpayer of due process of law. It is reasonable and necessary. Similar rules have been applied by the courts in other cases and are frequently found in the common law and in Federal statutes. It did not deprive the taxpayer of the right to submit all the facts bearing on the issue. The rule here has been approved by the court below and by all the courts that have had occasion to pass on it. It has also been applied by the Board of Tax Appeals in a number of cases. The presumption is in favor of its validity.

Aside from the regulation, the burden was upon the taxpayer to show the cost of what was sold.

This he did not and could not do. The impossibility of proving a material fact simply leaves him with an unenforceable claim.

ARGUMENT

I

THE TAXPAYER FAILED TO IDENTIFY THE VARIOUS LOTS OF STOCK PURCHASED BY HIM ON MARGIN, HENCE IT WAS PROPER TO CHARGE THE FIRST SALES AGAINST THE FIRST PURCHASES

In 1926 the taxpayer acquired, in various lots, 1,500 shares of U. G. I. stock at a total cost of $117,202.50. In 1928 (the taxable year), he bought an additional 1,000 shares of the same stock for $143,225, and in the same year he sold 1,300 shares of this stock for $192,599. All of these transactions were made through a broker on margin.

Section 112 of the Revenue Act of 1928 (*supra*, p. 2) provides that upon a sale of property the entire amount of the gain shall be recognized. Section 111 provides that the gain from such sale shall be the excess of the amount realized over the basis provided in Section 113. Section 113 (*supra*, p. 3) says that the basis of property acquired after February 28, 1913, shall be the cost. The parties here agree that these statutes are applicable; that shares of stock are identifiable, and for tax purposes are regarded as specific property; that the statutes referred to do not permit the merging or averaging of the cost of stock acquired at various prices over a period, but that each lot of stock pur-

chased carries with it its own cost which must be applied against the selling price of that particular lot in order to determine the proper gain or loss on that particular transaction. See *Skinner* v. *Eaton*, 45 F. (2d) 568, 569–570 (C. C. A. 2d) affirming 34 F. (2d) 575, certiorari denied, 283 U. S. 837; *Towne* v. *McElligott*, 274 Fed. 960 (S. D. N. Y.).

In this case the selling price of the stock in question is not disputed. The controversy is over the proper cost basis. The taxpayer contends, and the court below held, that the taxpayer identified the stock sold as the stock last acquired by him and that the cost of such last acquired stock furnished the proper basis for computing the gain. It is the Commissioner's position, and was found by the Board of Tax Appeals, that the identity of the various lots of stock purchased had been lost and that it was therefore proper to use as the basis the cost of the first acquired stock in accordance with Article 58, Regulations 74 (*supra*, p. 3), which provides:

> When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock. * * *[1]

[1] This regulation, commonly known as the "first in, first out" rule, has been in effect under all the Revenue Acts. Article 4, Paragraph 60, Regulations 33 (Revised), promulgated under the 1916 Act; Article 39, Regulations 45, 62, 65 and 69, promulgated under the Revenue Acts of 1918, 1921,

Since the purchases and sale here were all on margin, the real question in the case is whether marginal stock can be identified and whether the taxpayer did in fact identify the marginal stock sold in 1928.

The mechanics of a marginal transaction is a matter of common knowledge. Each customer is merely charged on the broker's books with the number of shares ordered. No entry is made on the books of the serial numbers of the certificates. The certificates are not issued in the name of the customer, but in the name of the broker or street names. The broker makes no allocation of the particular certificates to any particular client, nor are the certificates earmarked in any way. All stock of the same kind is commingled and held by the broker for the common benefit of all dealing in that particular stock. Marginal stock held by the broker is, therefore, a "fungible mass." The situation is similar in nature to the case of a grain elevator. A depositor may have a property in the

---

1924 and 1926, respectively; and Article 58 of Regulations 74 and 77, promulgated under the Revenue Acts of 1928 and 1932, respectively. It has received legislative and judicial approval. *Skinner* v. *Eaton*, *supra*; *Howbert* v. *Penrose*, 38 F. (2d) 577 (C. C. A. 10th). The court below has sustained and applied the rule in similar cases. *Snyder* v. *Commissioner*, 54 F. (2d) 57; *Snyder* v. *Commissioner*, decided September 18, 1934, 73 F. (2d) 5; *Horner* v. *Commissioner*, 72 F. (2d) 407; *Commissioner* v. *Merchants' & Mfrs.' F. Ins. Co.*, 72 F. (2d) 408.

grain therein although the keeper is at liberty to mix his own and other grain with the deposit and empty and refill the receptacle many times before making good his receipt to the depositor concerned. See *Sexton* v. *Kessler,* 225 U. S. 90, 97–98. So particular shares held on margin are not identifiable, because the common fund is the common property of all dealing in that stock and this common fund is in a constant state of flux. See *Snyder* v. *Commissioner,* 54 F. (2d) 57 (C. C. A. 3d), *supra.*

This case is typical. The taxpayer never received any certificates. No certificates were issued in his name. The taxpayer "just gave an order to the broker buy or to sell so many shares and received the notice the following day that so many shares were bought or sold." (R. 18.) No certificates were earmarked for the taxpayer on the broker's books of account and the broker could not advise the taxpayer of any specific certificates that were purchased for him in 1926 and 1928. (R. 10.) The broker "cleared through a clearing house and always kept or had certificates for exactly the number of shares that all of their customers were long but they could not say that certain certificates or certain numbers were the decedent's." (R. 18.) Under these circumstances, we submit, the Commissioner properly applied the regulation referred to above. It was designed to meet just such a situation as this and provides for a cost basis in these

transactions where identification is impossible.[2] See cases cited in footnote 1, *supra*. See also *Cole v. Helburn*, 4 F. Supp. 230 (W. D. Ky.); *Towne* v. *McElligott*, 274 Fed. 960, *supra*.

Although approving of the regulation, the court below held that it had no application here because the taxpayer identified the shares sold as the latest shares purchased. (R. 26–27.) The taxpayer's first purchases of stock were made with funds derived from his father's estate. He was sentimental about keeping the first 1,200 shares purchased as an inheritance from his father and intended to retain these shares as an investment and sell in speculation the more recently acquired stock. In giving orders to his brokers to sell 1,300 shares of stock in 1928, the taxpayer did not specify any particular shares to be sold, but an employee of the broker understood that the taxpayer desired to retain 1,200 shares to take the place of the funds which he had received from his father. The taxpayer also had made it plain to his associates that the 1,200 shares were in the nature of a permanent commitment on his part. (R. 10–17.) The court below held that taxpayer's communication to his

[2] The statement that identification is impossible in marginal transactions, while generally true, may be subject to certain exceptions, e. g., where each purchase on margin is made through a different broker. In such event the sale by one broker of all the stock previously purchased by him for the customer might operate to identify the lot sold. Such is not the case here.

broker of his intention to hold the 1,200 shares first purchased was in effect an order not to sell those shares and that this communication of intention was identification sufficient to take the case out of the rule (R. 26–27), despite the fact that the broker could not say what shares had been sold (R. 18). Thus the court allows a mere declaration of intention to take the place of the actual identification required by the regulation.

We submit the taxpayer's intention is without bearing on the question here. It is apparent from the language of the regulation that actual identification and not mere intent is the controlling factor. Effect must be given to what was actually done rather than to what the parties now say they intended to do. *Weiss* v. *Stearn*, 265 U. S. 242; *Clemmons* v. *Commissioner*, 54 F. (2d) 209 (C. C. A. 5th). That intent is not controlling in a case of this kind was recognized in *Skinner* v. *Eaton*, *supra*, where the Circuit Court of Appeals for the Second Circuit said (p. 570):

> The declarations of a taxpayer as to his intention to sell the more recently purchased stock and to retain his original holdings, made orally, are insufficient to change the result. They indicate merely a purpose which he may not have adhered to. *They in no way marked the particular shares of stock here under consideration, the identity of which the trial judge has found to have been lost.* (Italics supplied.)

And so in this case. The taxpayer merely gave orders to his broker to sell 1,300 shares of U. G. I. stock without specifying what shares to sell. The broker could not determine which shares were actually sold. (R. 18.) The fact that the taxpayer informed an employee of the broker of his intention to retain the first purchases is insufficient to change the result. It indicates merely a purpose which taxpayer may not have adhered to. It in no way marked the particular shares of stock under consideration, the identity of which the Board of Tax Appeals has found to have been lost.

Even in *Howbert* v. *Penrose, supra,* upon which the court below places so much reliance, it was said (p. 578):

> So it is of the question of intent of the seller, a point much labored at the trial and here; it is some evidence as to what was done, but not conclusive. The ultimate question is, What was done? * * *

What was done in this case is not disputed. In giving orders to his broker to sell 1,300 shares in 1928 the taxpayer did not specify any particular shares to be sold (R. 9, 18), and in executing the order the broker did not and could not identify the shares actually sold (R. 18).

The Board of Tax Appeals in a long line of cases has applied the regulation to facts similar to the facts at hand and held that intention is not controlling. *Leng* v. *Commissioner,* 22 B. T. A. 149;

Jenks v. *Commissioner*, 22 B. T. A. 910; *Hedrick* v. *Commissioner*, 24 B. T. A. 444; *Stryker* v. *Commissioner*, 21 B. T. A. 561; *Scanlon* v. *Commissioner*, 21 B. T. A. 1120; *Cleveland Trust Co.* v. *Commissioner*, 24 B. T. A. 132; *Finlay* v. *Commissioner*, 17 B. T. A. 828; *Mickler Holding Co.* v. *Commissioner*, 29 B. T. A. 300; *Kelchner* v. *Commissioner*, 31 B. T. A. 262; *Seelye* v. *Commissioner*, 29 B. T. A. 695.

In the first *Snyder* case, *supra* (54 F. (2d) 57, 59), the court below held that "a mental condition * * * falls short of evidential 'identification'." In *Commissioner* v. *Merchants' & Mfrs.' F. Ins. Co.*, *supra* (72 F. (2d) 408), and in *Horner* v. *Commissioner*, *supra* (72 F. (2d) 407), it held that intent was not controlling. In the second *Snyder* case, *supra* (73 F. (2d) 5),[3] the court again held that mere intent "without something more" was not sufficient to take the case out of the rule. And in this case the court once again held that mere intention standing alone was not sufficient to identify the shares sold. The court also held that even repeated declarations of that intention to the taxpayer's associates was not enough (R. 26), citing with approval *Skinner* v. *Eaton*, *supra*. But the court, in endeavoring to reconcile its earlier decisions, held that here there was "something more,"

[3] The second *Snyder* case was decided on the same day the instant case was decided and is now pending in this Court, No. 663, present term.

namely, the communication of the intent to the broker, which was sufficient to take the case out of the rule. However, we submit that where it is impossible even for the broker to identify (R. 18), a declaration of intent made to the broker is not different from a similar declaration made to the taxpayer's associates, as in the *Skimmer* case, *supra*. Since the broker cannot identify, it is not apparent how the communication of the taxpayer's intention to the broker can add anything to the intention itself.[4]

The court below sought to make a distinction between a sale of shares and a sale of certificates. See also second *Snyder* case, *supra*. It recognizes that in marginal transactions certificates cannot be identified, but holds that shares, as distinguished from certificates, are capable of identification. This so-called distinction does not exist in a case of this kind. It is true, as the court below stated, that shares of stock and certificates of stock are not one and the same; that a share of stock is the interest of the stockholder in the corporation, is of itself property and is the subject of conversion, while the certificate is the symbol or paper evidence of the ownership of the shares and is not the stock itself. It is also true that in marginal trading the

[4] The taxpayer in *Snyder* v. *Commissioner*, No. 663, agrees that since marginal stock is inextricably mixed, a direction to the broker to sell the last acquired stock first is merely evidence of intent and adds nothing of substance to a declaration of intent. See *Snyder* petition, p. 20.

rapid shifting of certificates between brokers may cause the certificates to go in one direction and the shares in another. But this merely serves to show the impossibility of identifying shares in a case of this kind.

Shares of stock as such have "no earmark which distinguishes one share from another", just as with grain of a uniform quality, one bushel is of the same kind and value as another. *Richardson* v. *Shaw,* 209 U. S. 365, 379; *Duncan* v. *Johnston & Co.,* 3 F. (2d) 422 (C. C. A. 6th), certiorari denied, 267 U. S. 600; *Hubbell* v. *Drexel & Co.,* 11 Fed. 115; *Caswell* v. *Putnam,* 120 N. Y. 153, 157; *Skowhegan Bank* v. *Cutler,* 52 Me. 509, 517. Shares of stock are intangible and rest in abstract legal contemplation. *Burrall* v. *Bushwick Railroad Co.,* 75 N. Y. 211, 217.

Since one share of stock is identical with every other share of the same issue, shares as such have no identity. But the law does recognize an identity in every share where such shares can be traced in some way, either on the books of the corporation or by certificates or by some other evidence of ~~indebtedness~~ ownership. As stated by Judge L. Hand in *Towne* v. *McElligott, supra* (274 Fed. 960, 963):

> The law may, and in fact does, recognize an identity in every share, which can indeed be traced upon the books of the company, at least until certificates are consolidated, and later subdivided. The purchase of a number

> of shares can be earmarked by the certificate, and it is an enormous convenience to keep the purchases separate. * * *

The usual method of identification is, of course, by tracing the shares through certificates. Shares of stock as such being incapable of actual delivery, some evidence of ownership must be used for purposes of symbolical delivery. And while title may be transferred in other ways, the usual transfer is effected through certificates which are documentary evidence of title. Ordinarily no one can get the benefit of ownership of stock except through and by means of certificates. *Disconto-Gesellschaft* v. *U. S. Steel Co.*, 267 U. S. 22, 28. For these and other reasons the law frequently identifies a share of stock by and with its physical representative. Thus stock may acquire a *situs* for the purpose of taxation where the certificates are found. *Burnet* v. *Brooks*, 288 U. S. 378; *DeGanay* v. *Lederer*, 250 U. S. 376; *First Nat. Bank of Boston* v. *Commissioner*, 63 F. (2d) 685 (C. C. A. 1st). A wrongful use of an endorsed certificate may be treated as a conversion of the stock itself. *McAllister* v. *Kuhn*, 96 U. S. 87, 89. A banker lending money to a person for his private use, on the security of stocks, the certificates of which show that he holds them as trustee for another, is chargeable, as party to the breach of trust, for the value of the trust property converted. *Duncan* v. *Jaudon*, 15 Wall. 165; *National Bank* v. *Insurance*

Co., 104 U. S. 54, 63. Where stock pledged as collateral can be identified by numbered certificates, the pledgor is entitled to have a return of his identical shares as evidenced by such certificates, and may treat a sale by the pledgee of such stock as a conversion, although the pledgee has at all times a sufficient number of shares of the same stock to meet the pledge. *Allen* v. *Dubois*, 117 Mich. 115. And where stock is owned outright (that is, not on margin) gain or loss on its sale is to be based on the cost of certificates delivered rather than on the cost of the certificates which the seller intended to but did not deliver. *Commissioner v. Merchants' & Mfrs.' F. Ins. Co., supra; Cole* v. *Helburn, supra.* Cf. *Howbert* v. *Penrose, supra.*

The question of stock identification often arises in cases dealing with the bankruptcy or insolvency of stock brokers. To get any standing except as general creditors, customers trading with a bankrupt broker must identify the original assets or trace them into other specific funds which came into the trustee's hands. *National City Bank* v. *Hotchkiss*, 231 U. S. 50; *Schuyler* v. *Littlefield*, 232 U. S. 707; *St. Louis & S. F. R. R.* v. *Spiller*, 274 U. S. 304, 310; *In re Byrne*, 32 F. (2d) 189, 190 (C. C. A. 2d), certiorari denied, *sub nom. Mohr* v. *Bielaski*, 280 U. S. 557. But where the stock purchased is susceptible of identification, the customer's right thereto is superior to that of a general creditor. *Denton* v. *Gurnett & Co.*, 69 F. (2d) 750 (C. C. A. 1st). The courts generally hold that

stock can be identified by means of certificates and if the customer can trace his stock held by the broker by certificate numbers he is entitled to a return of that particular stock. *In re T. A. M'Intyre & Co.*, 181 Fed. 955, 958 (C. C. A. 2d); *In re Ennis*, 187 Fed. 728 (C. C. A. 2d); *In re J. F. Pierson, Jr., & Co.*, 225 Fed. 889 (S. D. N. Y.), affirmed, 233 Fed. 519 (C. C. A. 2d); *In re J. C. Wilson & Co.*, 252 Fed. 631, 653–654 (S. D. N. Y.). But where the certificates cannot be traced, the courts in order to do justice and equity must rely upon a presumption or fiction to take the place of actual identification. In such cases the "grain-in-the-bin" doctrine is accepted and the courts hold that there is sufficient identification of the stock held by the bankrupt estate if the broker's "box" contains certificates in excess of those claimed by the purchasers of those stocks, provided there are no other claimants to that stock. This identification is based on the presumption that the stock on hand was purchased by the broker to meet his obligations. The fact that the customer is unable to put his finger upon the identical stock certificates purchased for him, or that the certificates in the box may be others than those originally purchased, is considered unimportant, since a certificate for a number of shares represents precisely the same kind and value of property as another certificate for a like number and kind of shares in the same corporation, and the presumption is that if the

broker disposes of the certificates first acquired he replaces them with like certificates later in order to keep on hand at all times sufficient stock to meet his obligations. See *Richardson* v. *Shaw*, 209 U. S. 365, *supra*; *Gorman* v. *Littlefield*, 229 U. S. 19; *Duel* v. *Hollins*, 241 U. S. 523; *Sexton* v. *American Trust Co.*, 45 F. (2d) 372 (C. C. A. 8th). The rationale of these decisions is that if the bankrupt estate has enough of the particular stock to cover all customers who are long on the day of the failure, then the presumption that the broker intended to keep their stock on hand is sufficient identification of the stock as theirs. If, however, the stock on hand is not sufficient to satisfy all long customers, no such presumption arises. *In re J. F. Pierson, Jr., & Co., supra.*

Thus the courts realize that while shares of stock in and of themselves have no identity, they may be identified by and through certificates. And where the identity of the certificates is lost, reliance must be placed on some presumption. So it is here. For tax purposes, stock may be identified by means of certificates, but where the identity of the certificates is lost the need for a presumption such as the one contained in the regulation becomes apparent. Conceding that stock may be identified in other ways than by means of certificates, such as by entry on the stock books of the corporation or by some other identifying evidence of ownership, we submit such is not the case here. The taxpayer, trading on

margin, was not dealing in identifiable stock certificates, or in any other evidences of ownership. The broker's books were not kept in such a way as to preserve the identity of the various purchases. Each share purchased by the taxpayer was identical with every other share and neither the broker nor the taxpayer could say that the shares sold were actually the last shares acquired. Under these circumstances, we submit the Commissioner was entirely justified in applying the regulations and in matching the sale against the first purchases.

II

THE REGULATION IS VALID

The taxpayer argued below and will undoubtedly contend here that the regulation, if applicable, is invalid for the reason that it violates the due process clause of the Constitution. A similar argument is advanced by the petitioner in *Snyder* v. *Commissioner*, No. 663, present term. The contention is without merit.

Since the attack is on the ground that the due process clause is violated, the question is simply whether the regulation is reasonable (*Mobile, J. & K. C. R. R.* v. *Turnipseed*, 219 U. S. 35, 43), that is, whether it "is appropriate to the case." *Hagar* v. *Reclamation District No. 108*, 111 U. S. 701, 708. This must be determined by the circumstances. *Reaves* v. *Ainsworth*, 219 U. S. 296, 304. The

regulation is altogether reasonable under the circumstances and was held to be so by the court below.

The Constitution has granted broad powers of taxation to Congress. Congress in exercising that power has undertaken to tax gains derived from the sale of property and to measure such gain by comparing the selling price of the property with its cost. The burden is placed on the taxpayer in each instance to show the cost of that which he has sold. In case of stock sales this burden can usually be met by showing the cost of stock certificates delivered. But in marginal transactions, particularly in pyramiding operations such as those in the *Snyder* case, it is impossible for the taxpayer to identify.[5] In such cases the need for such a rule as this seems apparent. The interests of both taxpayers and the Government required the adoption of some rule prescribing the measure of the tax. Obviously one of three rules was available, either the "first-in, first-out" rule, or that of averaging the cost of all the stock acquired, or that of "last-in, first-out." Of the three, we submit the "first-in, first-out" is the fairest and most reasonable to both the Government and taxpayers. It operates to the advantage of taxpayers as often as it does to the advantage of the Government. The rule has been in effect for a

[5] Unless the court below is right that directions to the broker is sufficient identification, which we submit it is not. See also footnte 2, p. 11, *supra*.

number of years. It was in effect when the transactions here in question were entered into. The taxpayer bought and sold the stock under the admonition of the law that if he could not identify the stock sold, his gain would be measured in this way. He cannot, therefore, complain that he has been deprived of his property without due process. *Orient Insurance Co.* v. *Daggs,* 172 U. S. 557, 566. The due-process clause is but an admonition of fair dealing (*Cohan* v. *Commissioner,* 39 F. (2d) 540, 545 (C. C. A. 2d)), and considering the circumstances, we submit the regulation is entirely fair and reasonable.

The taxpayer contends that the regulation creates a conclusive presumption of fact that the shares sold were those first acquired and since it operates to deny him a fair opportunity to rebut it is void under *Heiner* v. *Donnan,* 285 U. S. 312; *Bailey* v. *Alabama,* 219 U. S. 219, 238; and *Manley* v. *Georgia,* 279 U. S. 1, 5–6. But those cases deal with rules of evidence and the rule here is not so much a rule of evidence as it is a rule of substantive law. The regulation is only applicable in those instances where the taxpayer cannot identify. It does not establish a conclusive presumption of fact, but merely provides a method of computing the gain or loss in those cases where the exact facts are incapable of proof. Under such circumstances, the courts recognize the value of a rule of this kind as an expedient for the ready solution of disputes. Rules of this kind, sometimes called "conclusive

presumptions", are in reality rules of substantive law and are frequently found in the common law and have for many years been included in statutes. Such rules are not true presumptions at all. Cf. 2 Chamberlayne on Evidence, Sections 1086, 1087, 1159, *et seq.;* 5 Wigmore on Evidence (2d Ed.), Section 2492.

Among the so-called "conclusive presumptions" are: A child under seven years of age is unable to form a criminal intent (*Allen* v. *United States,* 150 U. S. 551, 558); a male child under fourteen years of age cannot commit the crime of rape, and the related presumption as to the age of consent by a female (see *Holland* v. *State,* 161 Ga. 492); tax deeds are conclusive as to compliance with requirements of tax laws (*Callanan* v. *Hurley,* 93 U. S. 387, 390, 392); a deed registered twenty years or more under a Tennessee statute is registered on lawful authority (*Webb* v. *Den,* 17 How. 576); the imposition of liability on cities for damages by mob violence (*City of Chicago* v. *Sturges,* 222 U. S. 313); stockholders are conclusively presumed to be citizens of the State in which the corporation is domiciled (*Muller* v. *Dows,* 94 U. S. 444; *Louisville Railroad Co.* v. *Letson,* 2 How. 497).

The difficulties of proof justified imposing liability upon the initial carrier for loss or damage to goods shipped on a through bill of lading. *Atlantic Coast Line* v. *Riverside Mills,* 219 U. S. 186.

The so-called "conclusive presumptions" are frequently met in Federal tax laws. For example, Section 3207 of the Revised Statutes, as amended by Section 1127 of the Revenue Act of 1926, c. 27, 44 Stat. 9 (U. S. C. App., Title 26, Sec. 136), establishes a conclusive presumption as to the validity of assessment in suits in equity by prior lienors. In Section 31 (b) of the Revenue Act of 1916, added by Section 1211 of the Revenue Act of 1917, c. 63, 40 Stat. 300, and Section 201 (b), (d), and (e) of the Revenue Act of 1918 and corresponding sections of the subsequent Acts, we find the precise counterpart of the present regulation. Under these statutes dividends are conclusively presumed to have been paid out of certain specified profits. The courts have frequently applied and upheld these provisions despite their conclusive character. *Helvering* v. *Canfield,* 291 U. S. 163; *Douglas* v. *Edwards,* 298 Fed. 229 (C. C. A. 2d), reversed on other grounds, 269 U. S. 204; *Leland* v. *Commissioner,* 50 F. (2d) 523 (C. C. A. 1st), certiorari denied, 284 U. S. 656; *Harder* v. *Irwin,* 285 Fed. 402 (N. D. N. Y.); *Mason* v. *Routzahn,* 8 F. (2d) 56 (N. D. Ohio), reversed, 13 F. (2d) 702 (C. C. A. 6th), reversed, 275 U. S. 175.

Congress is the judge of the degree of necessity which calls forth the statute (*Everard's Breweries* v. *Day,* 265 U. S. 545, 559), whether the necessity arises because of the difficulty of proof, as in this case, the similarity of objects, or because experi-

ence has shown that the thing declared by the statute to be true is so often true that the administration of justice will best be served by not permitting it to be questioned in any case. Considered as a rule of substantive law, we submit the regulation is reasonable under the circumstances and appropriate to the nature of the case. In similar circumstances the rule has been applied aside from the regulation (*Towne* v. *McElligott, supra*), and in somewhat analogous situations the courts have applied a similar rule as being the most reasonable rule available. Thus, where a trustee has mingled the monies of several defrauded claimants and the fund is insufficient to satisfy them all, it is held that the first withdrawals are to be charged against the first deposits and the claimants are entitled to be paid in the inverse order in which their monies went into the account. See *Cunningham* v. *Brown,* 265 U. S. 1, 12; *Clayton's Case* (1816 Ch.), 1 Merivale 572; cf. *Hewitt* v. *Hayes,* 205 Mass. 356, 365. See also *Empire State Surety Co.* v. *Carroll County,* 194 Fed. 593, 604–605 (C. C. A. 8th). Likewise, there is the analogy to payment upon an open account, where the law has always allocated the earlier payments to the earlier debts, in the absence of a contrary intention. See *Towne* v. *McElligott, supra,* p. 963. Compare also the presumption invoked in bankrupt brokers cases referred to under Point I, *supra.*

And even considered as a rule of evidence rather than a rule of substantive law, the regulation is not unconstitutional. The court below in the *Snyder* case, No. 663, said the presumption was rebuttable. Perhaps it would be more accurate to say that it does not arise until identification is shown to be impossible. The taxpayer is given every opportunity to identify the shares he has sold and to prove his loss or gain accordingly. The regulation does not deny the taxpayer a fair opportunity to offer testimony as in *Bailey* v. *Alabama, supra,* and in *Manley* v. *Georgia, supra.* Nor does it constitute an attempt to enact into existence a fact which does not and cannot be made to exist in actuality, as in *Heiner* v. *Donnan, supra.* The regulation meets the test laid down in *Mobile, J. & K. C. R. R.* v. *Turnipseed,* 219 U. S. 35, where this Court said (p. 43):

> If a legislative provision not unreasonable in itself prescribing a rule of evidence, in either criminal or civil cases, does not shut out from the party affected a reasonable opportunity to submit to the jury in his defense *all of the facts bearing upon the issue,* there is no ground for holding that due process of law has been denied him. (Italics supplied.)

See also *Cockrill* v. *California,* 268 U. S. 258, 261; *Yee Hem* v. *United States,* 268 U. S. 178, 183–184. It is clear that the regulation did not shut off from the taxpayer a reasonable opportunity to submit

all the facts bearing upon the issue. Indeed the rule comes into operation only when the taxpayer is unable to prove the identity of the shares sold. It is not the regulations which deny the taxpayer the right to identify, but the very nature of marginal transactions, in which the taxpayer voluntarily engaged, that prevents the identification. The taxpayer's position, in substance, is that the presumption upon which the Commissioner acted must be changed in his case because the manner in which he operated makes it impossible for him to show that the fact presumed did not in fact exist. The real burden of taxpayer's complaint is not that he has been deprived of an opportunity to make a defense, but rather that he has no defense to offer, which in turn is due, not to the assailed regulation, but to the nature of the transaction in which he voluntarily engaged. And it is because of the very nature of the transaction which makes identification impossible, that a rule of this kind becomes necessary. The rule is reasonable under the circumstances. It is certainly the most convenient rule from an administrative standpoint. It operates to the taxpayer's advantage as much as to his disadvantage. Under it he is taxed only on what is true income. He can offer no better rule.

The rule has been sustained by the court below and has received the approval of all the courts that have had occasion to pass upon it. It has been applied by the Board of Tax Appeals in the long

line of cases referred to above. Since it has received Congressional approval, the presumption is in favor of its constitutional validity. It should not be set aside unless it clearly operates to deprive the taxpayer of due process of law. See *Hylton* v. *United States*, 3 Dall. 171, 174; *Legal Tender Cases*, 12 Wall. 457, 531; *Graves* v. *Minnesota*, 272 U. S. 425, 428; *Whitney* v. *California*, 274 U. S. 357, 371. We submit the regulation is valid.

Aside from the regulation, the tax asserted in this case should have been sustained. The Commissioner determined the gain measured by the cost of the first stock acquired by the taxpayer. The burden was on the taxpayer to show that this was wrong. But because of the very nature of the transaction, it was impossible for the taxpayer to do this. The rule in *Burnet* v. *Houston*, 283 U. S. 223, is applicable. There this Court said (p. 228):

> The impossibility of proving a material fact upon which the right to relief depends, simply leaves the claimant upon whom the burden rests with an unenforcible claim, a misfortune to be borne by him, as it must be borne in other cases, as the result of a failure of proof.

Since the taxpayer did not, and could not, show that the Commissioner's determination was erroneous, the decision of the Board of Tax Appeals was plainly correct.

CONCLUSION

The decision below should be reversed.

Respectfully submitted.

J. CRAWFORD BIGGS,
Solicitor General.
FRANK J. WIDEMAN,
Assistant Attorney General.
JAMES W. MORRIS,
J. P. JACKSON,
Special Assistants to the Attorney General.

FEBRUARY, 1935.

U. S. GOVERNMENT PRINTING OFFICE: 1935

4

FILE COPY

Office Supreme Court, U. S.
FILED
JAN 17 1935
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 582.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

JAMES L. RANKIN, Executor of the Estate of Richard B. Turner, *Respondent.*

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

BRIEF FOR RESPONDENT IN OPPOSITION.

JOHN W. TOWNSEND,
Counsel for Respondent.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX.

	Page
Opinion Below	1
Jurisdiction	2
Question Presented	2
Statutes and Regulations Involved	2
Statement	2
Argument:	
1. The decision below does not conflict with other decisions; it consistently applies established principles of law to the particular facts of this case	5
2. Particular lots of shares purchased in a marginal account are capable of definite identification for purposes of later sale	8
3. To hold a taxpayer may not designate the lot of stock purchased in a margin account which is to be sold is to deny him the right given other owners of shares of stock to pick and choose the shares they desire to sell	10
4. To hold that shares of stock held on margin are not capable of identification and that the "first in, first out" rule must be applied to determine the cost basis in all sales of stock purchased on margin, would be to construe the regulations as providing a conclusive instead of a rebuttable presumption, thus rendering same invalid and unconstitutional	11
5. The decision below injects no element of uncertainty in the administration of the tax law; it sustains a fair and reasonable rule permitting a taxpayer by sufficiently manifested intent and consistent action to designate and earmark a particular lot of shares which he desires to sell out of his margin account	13
Conclusion	14

TABLE OF CASES.

	Page
Cole v. Helburn, 4 F. Supp. 230	7
Commissioner v. Merchants & Mfgrs. Fire Ins. Co., 72 F. (2d) 408	6
Heiner v. Donnan, 285 U. S. 312	11
Horner v. Commissioner, 72 F. (2d) 407	6
Howbert v. Penrose, 38 F. (2d) 577	6, 13
Skinner v. Eaton, 45 F. (2d) 568	6
Snyder v. Commissioner, 54 F. (2d) 57	6
Snyder v. Commissioner, 73 F. (2d) 5	6, 11
Towne v. McElligott, 274 Fed. 960	6
United States v. Alpha Portland Cement Co., 257 Fed. 432, 434	8
Vawter, George, v. Commissioner, 31 B. T. A. No. 165	8

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 582.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

JAMES L. RANKIN, Executor of the Estate of Richard B. Turner, *Respondent.*

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

BRIEF FOR RESPONDENT IN OPPOSITION.

OPINION BELOW.

The findings of fact and the opinion of the Board of Tax Appeals (R. 15-20) are reported in 26 B. T. A. 1204. The opinion of the Circuit Court of Appeals is reported in 73 F. (2d) 9.

Jurisdiction.

The decision of the Circuit Court of Appeals was rendered September 18, 1934 (R. 47). The petition for a writ of certiorari was filed December 15, 1934. The jurisdiction of this court is invoked under Sec. 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

Whether 1000 shares of stock held on margin and sold in 1928 were, as a matter of fact, under the particular circumstances in this case, identified as the same lot purchased by the taxpayer earlier in the year.

Statutes and Regulations Involved.

The applicable provisions of the Revenue Act of 1928 and of the Treasury Regulations are set forth in the petition for the writ.

Statement.

Since this case involves primarily only a question as to the sufficiency of the evidence to support the taxpayer's contention respecting the fact of identification, a more complete summarization of the facts is presented below than in petitioner's statement.

In 1926 the taxpayer, Richard B. Turner, now deceased, received in distribution of his father's estate $20,000 in bonds (R. 30). He did not believe in bonds and wanted to change this inheritance into stock (R. 30). At his direction his attorney opened for him a margin account with a Philadelphia broker and with the proceeds of the bonds purchased on margin 1200 shares of United Gas Improvement stock at about 98 (R. 28, 30-31). He considered this purchase an investment (R. 37.)

For nearly two years Turner had no further marginal transactions in this or any other stock (R. 28, 31). At the

beginning of 1928 his margin account showed 1500 shares of U. G. I. stock long, the additional 300 shares representing a 25 per cent stock dividend on November 22, 1926 (R. 28). These 300 shares, received as a stock dividend, were sold on May 8, 1928 (R. 29), and there is no dispute between the parties as to the basis used in computing the profit thereon.

During 1928 Turner was kept away from his business by a serious illness and began to play the market as a pastime (R. 31, 38). Beginning on March 14, 1928, and continuing throughout the remainder of the year he bought and sold on margin in the same account a large number of stocks, the transactions usually being in 500 and 1000 share lots (R. 31-32).

Included in these speculative (R. 37) transactions of 1928 was a purchase of a lot of 1000 shares of U. G. I. stock on June 8, 1928, at about 143¼ (R. 28-29) which he sold (as claimed by respondent and as held by the court below) in two lots of 500 shares each on October 22 and November 7 at about 147½ (R. 29).

The uncontradicted evidence showed that Turner was extremely sentimental about keeping the original 1200 shares considered as an inheritance from his father (R. 30, 34-35); that he at all times intended to keep those particular shares and to sell in 1928 the 300 shares received as stock dividend and the 1000 shares purchased in June of that year (R. 32-33); that he fully communicated that intention both to his business associates (who handled his affairs for him during his illness) and to the broker (R. 33, 35); that his decisions to sell were reached on that basis (R. 36); that his books and records were kept and his tax return made on that basis (R. 38); that he at all times and repeatedly emphasized the distinction between the 1200 shares which he was holding as an investment and the 1000 shares which he bought and sold as a speculation (R. 33-38); and that he did everything in his power and control to effect that intention. Both lots of stock having been bought on margin

he did not from the nature of things have physical custody and control of the certificates, but he saw to it that the broker was informed as to which shares he was keeping and which shares he was selling (R. 33, 35). The Board found (R. 18) as a fact:

> "The decedent always intended to retain the ownership on margin of 1200 shares of the United Gas Improvement Co. stock since he had faith in the company and desired to hold that in lieu of the bonds which he had received from the estate of his father."

The Commissioner of Internal Revenue held that the shares sold in October and November, 1928, were not capable of identification by certificates as being from the lot purchased in June, 1928, and that the so-called "first in, first out" rule of Art. 58, Regulations 74 (quoted in the petition herein) should be applied to determine the cost of the shares sold (R. 17). He thereby arbitrarily determined that the 1300 shares sold in 1928 consisted of 1040 shares out of the original 1200 shares plus 260 of the shares received as a stock dividend, and that the total basis for computing profit or loss should thus be reduced to $99,735 and the taxable profit correspondingly increased from $25,933.50 to $92,864 (R. 17-18). This arbitrary method of computing the profit in turn necessitated a very complicated, elaborate, and equally arbitrary prorating of the cost of the 1200 shares originally purchased as set forth at R. 17-18.

The Board sustained (R. 18-20) this arbitrary determination of the Commissioner and completely ignored the evidence that Turner's *intention* not to sell the 1200 shares purchased in 1926 had been *communicated* to the broker, and that everything had been done by the taxpayer which, in the nature of the case, could in fact be done by him to identify and specify the *lot* of shares from which the October and November sales were made.

The Circuit Court of Appeals reversed (R. 44-47) the Board, holding that full effect must be given to the commu-

nication of the taxpayer's intention to the broker respecting the specific lots to be sold and not to be sold, which amounted, under the principle established in several previously decided cases (which were discussed), to identification in fact of the lot from whence came the shares sold. The court held (R. 46-47):

> "The Commissioner, the Board of Tax Appeals affirming him, ignored this action of the petitioner on the theory that the U. G. I. stock, which from time to time he purchased on margin, and later sold, could be identified only by certificates; * * *
>
> That was error. What was bought and sold were shares, not certificates. * * * Shares as distinguished from certificates are property subject to conversion and capable of identification. * * *
>
> The petitioner's instructions excluding from sale the shares first purchased were in effect an identification of the shares later sold as those last purchased.
>
> While the petitioner, in identifying his shares, might have been more specific in his instructions to his broker, those he gave stand uncontradicted; indeed, they have not been questioned. We think they were enough to take the case out of the rule and that, in consequence, the deficiency tax in issue is invalid to the extent that it is based on gains in sales of U. G. I. shares reckoned on the purchase price of the original 1200 shares."

ARGUMENT.

1. *The decision below does not conflict with other decisions; it consistently applies established principles of law to the particular facts of this case.*

Petitioner does not urge that there is any conflict in fact between the decision below and the decisions in the other cases cited, but that such decision merely "conflicts in principle" with such cases. It is not alleged that any court has given a negative answer to the question which petitioner asserts is here presented. By reason of the marked difference in the factual situations it cannot be said that the deci-

sions of the several circuit courts are in conflict. The court below itself found no difficulty in distinguishing the other cases on their facts; it did not indicate any disagreement with the principles of law established by other cases.

As pointed out in the petition, the so-called "first in, first out" rule of the regulations has frequently been considered and applied by the courts. *Howbert v. Penrose*, 38 F. (2d) 577; *Skinner v. Eaton*, 45 F. (2d) 568; *Snyder v. Commissioner*, 54 F. (2d) 57; *Horner v. Commissioner*, 72 F. (2d) 407; *Commissioner v. Merchant's & Mfgrs. Fire Insurance Co.*, 72 F. (2d) 408; *Snyder v. Commissioner*, 73 F. (2d) 5. See also *Towne v. McElligott*, 274 Fed. 960. The validity of the rule, when construed as a presumption as to the property sold *where no evidence is offered as to identity of lots and dates of purchase*, is now hardly open to question. *Skinner v. Eaton, supra.*

The court below, consistently with these prior decisions, ruled identification to be "a matter of fact" (R. 45), and upon a careful consideration of the evidence held it to establish that Turner as a matter of fact had identified the stock sold in October and November, 1928, as being the lot purchased in June, 1928. The case thus turned on the weight and sufficiency of the evidence to support the Board's conclusions, and the Board was reversed because of its failure to give effect to the communication of Turner's intention to his broker respecting the specific lots of stock to be sold and not to be sold, and to the corroborating evidence as to identification.

The court did not, as suggested at page 7 of the petition, allow "a mere declaration of intention to take the place of the factual identification required by the regulation"; it was careful to point out that under the decided cases, "his 'intention' • • • clearly was not enough to take the case out of the rule" (R. 46), and that there was "something else" in this case (R. 45). This "something else" was stated (R. 46) to be:

> "What Turner did in this case, acting and speaking through his attorney, was to communicate to his broker

his intention to hold for investment the shares of U. G. I. he originally purchased. His decisions to sell like shares later purchased were reached on that basis; his books and records were kept on that basis; and, accordingly, his income tax return was made on that basis."

There is no conflict between the decision below and that in *Skinner v. Eaton, supra*, such as suggested at page 5 of the petition. That case did not involve stock purchased on margin. In that case there was some evidence of the taxpayer's intent, *expressed several years previous to the sale*, to retain his first purchases but no proof that any effort was made to carry this intention into effect or to keep a record of the stocks acquired and sold. Here Turner communicated his intent to the broker and *did everything that it was possible to do to identify the lot of shares to be sold* and especially to preclude the sale of the lot purchased in 1926. The *Skinner* case did not hold, nor even suggest as *dicta*, that shares of stock purchased on margin *could not* be identified, or that shares could *only* be identified by certificate numbers.

Howbert v. Penrose, supra, is not only consistent with the decision below, but seems to go further and to hold that the declared intention of the taxpayer as to what stock is to be sold is sufficient in itself. The two *Snyder* cases did, however, involve marginal transactions. They were decided by the same court which decided this case, and the second *Snyder* case was decided the very same day as the present. The court distinguished those cases on their facts and it cannot reasonably be contended the two decisions thus simultaneously rendered are in conflict. Neither the *Horner* nor the *Merchants* cases involved marginal transactions and there can be no conflict. They are cases where the stock actually identified as sold was not that intended to be sold. *Cole v. Helburn*, 4 F. Supp. 230, did not involve a marginal sale, and was simply a case where no instructions were given the broker as to what stock to sell.

It is significant that the Board of Tax Appeals has cited the decision below with approval and as being consistent with the previously decided cases by the courts and the Board. See *George Vawter v. Commissioner*, 31 B. T. A. No. 165, decided Dec. 14, 1934.

Here we have clear and convincing evidence as to just what property was to be sold. The court was correct in holding there is no reason for applying the presumption of the regulations. By the very terms of Art. 58 the presumption only applies where the "identity of the lots cannot be determined."

It is a most unreasonable contention advanced here by the Commissioner that Turner must be found to have sold the stock purchased in 1926 when the evidence is conclusive that he did not want to sell this particular stock and did everything he could do to keep from selling it. As well observed in *United States v. Alpha Portland Cement Co.*, 257 Fed. 432, 434, "The mind staggers over giving sanction to a finding that something is true which we know is not true."

2. *Particular lots of shares purchased in a marginal account are capable of definite identification for purposes of later sale.*

The Government in this petition again renews its discredited contention that shares of stock are not capable of identification except by certificates. *The Government has never been sustained by any court in such contention,* and cites no cases supporting such a view. The decisions are the other way. As pointed out in *Snyder v. Commissioner*, 73 F. (2d) 5, what are bought and sold in a margin account are *shares of stock,* not certificates which are mere evidence of title to the shares which constitute the property owned. The court there held:

> "From the petitioner's statement of fact and his position on the law, it is obvious he has confused identification of shares and identification of certificates in

transactions of sale. The rule deals with the sale and identification of 'shares of stock in a corporation,' not with sale and identification of certificates. Shares of stock and certificates for shares of stock are different legal entities. Shares of stock 'are intangible and rest in abstract legal contemplation'. They are the interest or right which the owner has in the management, profits and assets of a corporation. 14 C. J. Secs. 506, 509. Though incorporeal, they nevertheless are property and are the subject of conversion. 14 C. J. Sec. 509; 7 R. C. L. Sec. 166; *Skinner v. Eaton, Collector,* 45 Fed. (2d) 568. A certificate of stock, on the other hand, is the symbol or paper evidence of the ownership of shares; it is not the stock itself. It is merely written evidence, and then only *prima facie* evidence, of the ownership thereof by the person designated therein and of the rights and liabilities resulting from such ownership. 14 C. J. Secs. 698, 701, 702, 707, 709, 710, 1043. *Howbert v. Penrose,* 38 Fed. (2d) 577, 579. A stockholder may prove his ownership of shares by evidence other than that of the certificate, 14 C. J. Sec. 1272; and he may dispose of his shares and surrender his title therein by sale accompanied with delivery of a certificate in his name which he has endorsed with with a blank assignment and power of attorney authorizing the transfer. 14 C. J. Secs. 1033, 1050; 7 R. C. L. Secs. 239, 243. As between seller and buyer the shares pass by mere delivery of the certificate, so endorsed, though the transfer as between the new owner and the corporation is not complete until made on the books of the corporation. When the new owner of the shares sells them without first having them transferred to himself on the books of the corporation and makes delivery by handing over the certificates so endorsed in blank by the original holder and starts it on its wanderings through the 'street', the shares may go in one direction and the certificates in another; the shares, however, always being represented (in the rapid shifting of certificates between brokers) by a like certificate in the name of another, with endorsement in blank, held for the owner. Then 'ownership follows the owner, not the certificate'. *Howbert v. Penrose,* 38 Fed. (2d) 577, 579."

At page 9 of the petition the Commissioner urges that since "shares of stock bought on margin are not represented by identifiable certificates, it is utterly impossible to identify them." Significantly the regulation only applies where "the identity of the *lots* cannot be determined." Of course a lot of stock bought on margin is identifiable by the records of the broker and of the taxpayer. Each transaction is earmarked. There is no more difficulty in identifying specific lots of shares bought on margin than the costs of different lots. The same records show both lot and the cost of the same. The man in the street would certainly not conceive of any such difficulty in identification as the Commissioner purports to find.

3. *To hold a taxpayer may not designate the lot of stock purchased in a margain account which is to be sold is to deny him the right given other owners of shares of stock to pick and choose the shares they desire to sell.*

The absurd result of any such rule as the petitioner seeks to establish in this case demonstrates the correctness of the decision below. It cannot be disputed that a taxpayer owning shares of stock for which he has certificates may pick out and sell those having a cost to him which will produce a gain or loss as the taxpayer may desire. Nor can it be disputed that a taxpayer having different marginal accounts in each of which he has purchased lots of the same stock may likewise pick out a lot in a given account which will produce a gain or loss as may be desired. The Commissioner could not claim the designation of a given account was not a sufficient identification of what lot was sold. But the Commissioner contends that where more than one lot of the same stock are purchased in the same marginal account the taxpayer is to be precluded from identification of a particular lot sold, and that such a taxpayer is to be denied the right, afforded to all other classes of taxpayers, to exercise his own free will in deciding which lot and what property he wishes to sell.

Where, as in the present case, the taxpayer does all that can be done in the circumstances to identify the lot to be sold, where he not only has a mental intent respecting the stock to be sold but crystalizes this intent into action by directing his broker which lot to sell and which to hold, where his intention of what is to be sold is evidenced by contemporaneous overt acts, and is thus capable of real proof, there is every reason for holding that the taxpayer has successfully identified the shares and is entitled to the same basis as though he had certificates to evidence his shares rather than a chose in action of a different nature. The obvious purpose of the regulation is to give a rule for determining a factor in computing taxable profit in the absence of proof as to such factor—but not to deny the right of proof.

4. *To hold that shares of stock held on margin are not capable of identification and that the "first in, first out" rule must be applied to determine the cost basis in all sales of stock purchased on margin, would be to construe the regulations as providing a conclusive instead of a rebuttable presumption, thus rendering same invalid and unconstitutional.*

If the government is correct in its contention that the "first in, first out" rule must be applied in all sales of stock in a marginal account the obvious effect is to preclude the taxpayer from proving what shares and what property he intended to and did sell. Thus the regulation, when applied in such cases, will establish a conclusive and not a rebuttable presumption. If so construed it is clearly invalid and unconstitutional under *Heiner v. Donnan*, 285 U. S. 312.

That the regulation does not establish a conclusive presumption in marginal transactions and is therefore valid was ruled in *Snyder v. Commissioner*, 73 F. (2d) 5, where the court held:

"The usual ground of attack has been that the rule is arbitrary and capricious and therefore in contravention of the due process clause of the Fifth Amendment to the Constitution. This court has held that while the rule is, from the very nature of the situations to which it applies, fixed and peremptory and in that sense arbitrary, it is, from the latitude of its words, not inflexible or capricious and therefore is not unreasonable. Since this pronouncement, *Heiner v. Donnan*, 285 U. S. 312, has been decided. On that case the petitioner here takes a new stand. By that decision the Supreme Court held that Section 302(c) of the Revenue Act of 1926, creating a presumption that gifts made within two years of the donors' death were made in contemplation of death, was unconstitutional. The petitioner says that the rule which, on failure to identify shares sold, affords a presumption that the shares sold were those first bought is likewise unconstitutional. There is really no analogy between the provision of the statute under consideration by the Supreme Court in the *Heiner* case and the terms of the rule here under discussion. There the presumption was 'conclusive' and made so by the statute. Here the presumption is rebuttable, hence constitutional. *Cockrill v. California*, 268 U. S. 258, 261; *Yee Hem v. United States*, 268 U. S. 178, 183-184; *Mobile, J. & K. C. R. R. v. Turnipseed*, 219 U. S. 35, 42-43. The taxpayer is given every opportunity to identify the shares he has sold and to prove his loss or gain accordingly. Indeed, the rule comes into operation only 'when' the identity of the shares sold cannot be determined, which usually happens when the owner in ordering their sale has failed to identify the lots in which they were purchased. In such case there must be some way of determining for the benefit of the taxpayer his losses or gains in his taxable transactions and similarly, of determining what taxes the government is entitled to exact. Except for this rule or some similar rule, efficiently to administer the revenue act, a vast multitude of potential taxpayers dealing in the purchase and sale of shares on margain and actually making profits would escape taxation because of their inability or disinclination to identify the shares sold and the government would lose the taxes which the statute imposes."

The court therefore clearly indicated that the regulation would be invalid if construed, as here contended by petitioner, to preclude identification. The same conclusion was reached in *Howbert v. Penrose, supra,* where the court said:

> "The Government has not the power to say that if the taxpayer sells any of his holdings in a particular company, it can say conclusively that he sold the stock bought at the cheapest price or the shares purchased before or after a certain date. He has the right to decide that himself."

5. *The decision below injects no element of uncertainty in the administration of the tax law; it sustains a fair and reasonable rule permitting a taxpayer by sufficiently manifested intent and consistent action to designate and earmark a particular lot of shares which he desires to sell out of his margin account.*

Where a taxpayer, as in this case, by clear and convincing evidence establishes the lots of marginal stock to be sold, that is sufficient identification; where there is no such clear earmarking of the lot sold there is no identification. That seems to be the principle of law involved in this case. It is hard to see how any such holding can possibly, as petitioner suggests, "create considerable confusion and doubt as to the proper rules to be applied in these cases".

Obviously no principle can be formulated which will relieve the taxing officials and the Board from considering evidence in particular cases as they arise, or from their duty to make findings of fact as to whether the taxpayer did or did not by properly *manifested* intent and overt acts designate the lot of shares in his marginal account to be sold.

Conclusion.

No proper case is here presented, under the provisions of Rule 38 of this court, for the granting of the writ prayed for. It is submitted that the decision below is correct and is in harmony with the decided cases. The petition should be denied.

Respectfully submitted,

John W. Townsend,
Counsel for Respondent.

January, 1935.

FILE COPY

Office Supreme Court, U. S.
FILED
MAR 11 1935
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934

No. 582

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

JAMES L. RANKIN, Executor of the Estate of Richard B. Turner, *Respondent.*

On a Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

BRIEF FOR THE RESPONDENT.

JOHN W. TOWNSEND,
Counsel for Respondent.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX.

	Page
Opinions below	1
Jurisdiction	2
Questions Presented	2
Statutes and Regulations Involved	2
Statement of the Case	2
Summary of Argument	6
Argument	8
I. The Commissioner's disregard of the usual incidents of stock ownership and of the admitted intention of both the taxpayer and his broker concerning the lot of shares actually sold, and the unfair and unreasonable result of the deficiency determination, clearly demonstrate error in his method of computing the proposed tax and establish the correctness of the decision below	8
(a) A purchaser of stock on margin is the owner of the stock, and has rights and liabilities as such	9
(b) The effect of the Commissioner's determination is to deny the taxpayer holding stock on margin the right to make his own decision as to what shares he should sell and when, and therefore is to deny him fundamental incidents of ownership and rights accorded to taxpayers holding stock by identifiable stock certificates; the result is both arbitrary and discriminatory	10
(c) A further result of the Commissioner's determination is to deny any effect to the	

Page

fundamental factor universally held determinative of the very legality of a marginal transaction, namely, the intent of the purchaser; this is corrected by the decision of the court below 14

(d) The admission of the government that if the taxpayer's contentions are not sustained it "simply leaves him with an unenforceable claim" in itself illustrates the arbitrary and unfair character of the Commissioner's determination and argues strongly for the correctness of the decision below 17

II. The court below properly ruled that the 1000 shares held in the margin account and sold in 1928 could be and were identified as a lot purchased by taxpayer earlier in the same year; and that the cost of that specific lot is the basis for computing the taxable gain 18

(a) Shares of stock held on margin are capable of identification by the specific lots purchased and sold, the lots being earmarked by the separate transactions, recorded, in the books and records of the purchaser and the broker, and it is immaterial that identification can not be made through means of stock certificates..... 18

(b) The identity of a lot of stock sold out of a margain account can accurately be determined by reference to the intent of the seller as evidenced by his contemporaneous acts; such a rule is fair both to the taxpayer and the government and is capable of practical application 25

(c) The decision below is in full harmony with established principles of the law of marginal transactions and the law of sales.. 28

Page

(d) The holding below is entirely consistent with and is supported by the decision of the federal courts in tax cases involving identification of stock sold 29

(e) The facts in the present case are sufficient to distinguish it from *Snyder v. Helvering*, No. 663, now pending before this court 31

III Even if the 1000 shares sold were not identified, the Commissioner's artificial and arbitrary "first in, first out" rule does not control this case 33

(a) By its very terms Article 58, Regulations 74, providing for the "first in, first out" presumption, can not be applied in cases like the present 33

(b) If shares of stock are incapable of identification, as a matter of law, the "first in, first out" principle can not be applied to any sale of corporate stock, because such a rule may only be construed as reasonable and valid where applied to property which is in fact and in law capable of identification 35

(c) If shares of stock held on margin are incapable of identification the "first in, first out" rule can not be applied in case of a sale of such stock, because it would create an irrebuttable presumption of fact and thereby be unconstitutional, as denying due process of law 38

IV. If for any reason the "first in, first out" rule does not control, and if the shares sold are not identified, then the taxable profit must be ascertained under established principles of income tax law of general application 41

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934

No. 582

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

JAMES L. RANKIN, Executor of the Estate of Richard B. Turner, *Respondent.*

On a Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

BRIEF FOR THE RESPONDENT.

OPINIONS BELOW

The findings of fact and the opinion of the Board of Tax Appeals (R. 8-11) are reported in 26 B.T.A. 1204. The opinion of the Circuit Court of Appeals (R. 25-27) is reported in 73 F. (2d) 9.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered September 18, 1934, (R. 28). The petition for a writ of certiorari was filed December 15, 1934, and was granted February 4, 1935 (R. 29). The jurisdiction of this court is invoked under Sec. 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented

1. Whether 1000 shares of stock held on margin and sold in 1928 were capable of identification and were in fact identified as the same lot purchased by the taxpayer earlier in the year.

2. Whether the so-called "first in, first out" presumption of the income tax regulations may be applied in the event the court holds shares of stock held on margin were not identified.

3. How should the gain on the sale of the shares be computed if the stock cannot be identified and if the "first in, first out" rule does not control?

Statutes and Regulations Involved

The applicable provisions of the Revenue Act of 1928 and of the Treasury Regulations applicable to property held for investment* are set forth in the brief for petitioner.

Statement of the Case

Since this case to some extent involves the question as to the sufficiency of the evidence to support the taxpayer's contention respecting the fact of identification, a more complete summarization of the facts is presented below than in petitioner's statement.

In 1926, the taxpayer, Richard B. Turner, now deceased, received in distribution of his father's estate $20,000 in

*As to whether applicable to stock purchased and sold in same year see petitioner's brief in *Snyder v. Commissioner*, No. 663.

bonds (R. 16). He did not believe in bonds and wanted to change this inheritance into stock (R. 16). At his direction his attorney opened for him a margin account with a Philadelphia broker and with the proceeds of the bonds purchased on margin 1200 shares of United Gas Improvement stock at about 98 (R. 15-17). He considered this purchase an investment (R. 20-21).

For nearly two years Turner had no further marginal transactions in this or any other stock (R. 15, 16-17). At the beginning of 1928 his margin account showed 1500 shares of U.G.I. stock long, the additional 300 shares representing a 25 per cent stock dividend on November 22, 1926 (R. 15). These 300 shares, received as a stock dividend, were sold on May 8, 1928 (R. 15), and there is no dispute between the parties as to the basis used in computing the profit thereon.

During 1928 Turner was kept away from his business by a serious illness and began to play the market as a pastime (R. 16-17, 21). Beginning on March 14, 1928, and continuing throughout the remainder of the year he bought and sold on margin in the same account a large number of stocks, the transactions usually being in 500 and 1000 share lots (R. 16-17).

Included in these speculative (R. 20-21) transactions of 1928 was a purchase of a lot of 1000 shares of U.G.I. stock on June 8, 1928, at about 143¼ (R. 15) which he sold (as claimed by respondent and as held by the court below) in two lots of 500 shares each on October 22 and November 7 at about 147½ (R. 15).

At the end of 1928 taxpayer's margin account was long 1200 shares of U.G.I., the same number he had held since 1926 (R. 17).

The uncontradicted evidence showed that Turner was extremely sentimental about keeping the original 1200 shares considered as an inheritance from his father (R. 16, 18-19); that he at all times intended to keep those particular shares and to sell in 1928 the 300 shares received

as stock dividend and the 1000 shares purchased in June of that year (R. 17-18); that he fully communicated that intention both to his business associates (who handled his affairs for him during his illness) and to the broker (R. 18-19); that his decisions to sell were reached on that basis (R. 20); that his books and records were kept and his tax return made on that basis (R. 21); that he at all times and repeatedly emphasized the distinction between the 1200 shares which he was holding as an investment and the 1000 shares which he bought and sold as a speculation (R. 18-21); and that he did everything in his power and control to effect that intention. Both lots of stock having been bought on margin he did not from the nature of things have custody or control of the certificates, but he saw to it that the broker was informed as to which shares he was keeping and which shares he was selling (R. 17-19). The Board of Tax Appeals found (R. 9) as a fact:

> "The decedent always intended to retain the ownership on margin of 1200 shares of the United Gas Improvement Co. stock since he had faith in the company and desired to hold that in lieu of the bonds which he had received from the estate of his father."

The Commissioner of Internal Revenue held that the shares sold in October and November, 1928, were not capable of identification by certificates as being from the lot purchased in June, 1928, and that the so-called "first in, first out" rule of Art. 58, Regulations 74, should be applied to determine the cost of the shares sold (R. 9). He thereby arbitrarily determined that the 1300 shares sold in 1928 consisted of 1040 shares out of the original 1200 shares plus 260 of the shares received as a stock dividend, and that the total basis for computing profit or loss should thus be reduced to $99,735 and the taxable profit correspondingly increased from $25,933.50 to $92,864 (R. 9). This arbitrary method of computing the profit in turn necessitated a complicated and equally arbitrary prorating of

the cost of the 1200 shares originally purchased as set forth at R. 9.

The Board of Tax Appeals sustained (R. 8-11) this arbitrary determination of the Commissioner and completely ignored the evidence that Turner's *intention* not to sell the 1200 shares purchased in 1926 had been *communicated* to the broker, and that everything had been done by the taxpayer which, in the nature of the case, could in fact be done by him to identify and specify the *lot* of shares from which the October and November sales were made.

The Circuit Court of Appeals reversed (R. 25-27) the Board, holding that full effect must be given to the communication of the taxpayer's intention to the broker respecting the specific lots to be sold and not to be sold, which amounted, under the principle established in several previously decided cases (which were discussed), to identification of the lot from whence came the shares sold. The court held (R. 27):

> "The Commissioner, the Board of Tax Appeals affirming him, ignored this action of the petitioner on the theory that the U.G.I. stock, which from time to time he purchased on margin, and later sold, could be identified only by certificates; * * *
>
> That was error. What was bought and sold were shares, not certificates. * * * Shares as distinguished from certificates are property subject to conversion and capable of identification. * * *
>
> The petitioner's instructions excluding from sale the shares first purchased were in effect an identification of the shares later sold as those last purchased.
>
> While the petitioner, in identifying his shares, might have been more specific in his instructions to his broker, those he gave stand uncontradicted; indeed, they have not been questioned. We think they were enough to take the case out of the rule and that, in consequence, the deficiency tax in issue is invalid to the extent that is it based on gains in sales of U.G.I. shares reckoned on the purchase price of the original 1200 shares."

Summary of Argument

I. *The Commissioner's disregard of the usual incidents of stock ownership and of the admitted intention of both the taxpayer and his broker concerning the lot of shares actually sold, and the unfair and unreasonable result of the deficiency determination, clearly demonstrate error in his method of computing the proposed tax and establish the correctness of the decision below.*

A purchaser of stock on margin is the owner of the stock, and has rights and liabilities as such. *Richardson* v. *Shaw*, 209 U. S. 365.

The effect of the Commissioner's determination is to deny the taxpayer holding stock on margin the right to make his own decision as to what shares he should sell and when, and therefore is to deny him fundamental incidents of ownership and rights accorded to taxpayers holding stock by identifiable stock certificates. Such result is not only arbitrary but discriminatory. *Howbert* v. *Penrose*, 38 F. (2d) 577. A further result of the Commissioner's determination is to deny any effect to the fundamental factor universally held determinative of the very legality of a marginal transaction, namely, the intent of the purchaser. These results are corrected by the decision of the court below.

The admission of the government that if the taxpayer's contentions are not sustained it "simply leaves him with an unenforcible claim" in itself illustrates the arbitrary and unfair character of the Commissioner's determination and argues strongly for the correctness of the decision below.

II. *The court below properly ruled that the 1000 shares held in the margin account and sold in 1928 could be and were identified as a lot purchased by taxpayer earlier in the same year; and that the cost of that specific lot is the basis for computing the taxable gain.*

Shares of stock held on margin are capable of identification by the specific lots purchased and sold, the lots be-

ing earmarked by the separate transactions recorded in the books and records of the purchaser and the broker, and it is immaterial that identification can not be made through means of stock certificates. *Richardson* v. *Shaw*, 209 U.S. 365; *Gorman* v. *Littlefield*, 229 U. S. 19; *Duel* v. *Hollins*, 241 U.S. 523; *Snyder* v. *Commissioner*, 73 F. (2d) 5.

The identity of a lot of stock sold out of a margin account can accurately be determined by reference to the intent of the seller as evidenced by his contemporaneous acts; such a rule is fair both to the taxpayer and the government, and is capable of practical application.

The decision below is in full harmony with established principles of the law of marginal transactions and the law of sales. It is also entirely consistent with and is supported by the decisions of the federal courts in tax cases involving identification of stock sold.

The facts in the present case are sufficient to distinguish it from *Snyder* v. *Helvering*, No. 663, now pending before this court.

III. *Even if the 1000 shares sold were not identified, the Commissioner's artificial and arbitrary "first in, first out" rule does not control this case.*

By its very terms Article 58, Regulations 74, providing for the "first in, first out" presumption, cannot be applied in cases like the present.

If shares of stock are incapable of identification, as a matter of law, the "first in, first out" principle can not be applied to *any sale* of corporate stock, because such rule may only be construed as reasonable and valid where applied to property which is in fact and in law capable of identification. In any event, if shares of stock held on margin are incapable of identification the "first in, first out" rule can not be applied in case of a sale of such stock, because it would create an irrebuttable presumption of fact and thereby be unconstitutional, as denying due process of law. *Heiner* v. *Donnan*, 258 U.S. 312; *Manley* v. *Georgia*, 279 U.S. 1.

IV. *If for any reason the "first in, first out" rule does not control, and if the shares sold are not identified, then the taxable profit must be ascertained under established principles of income tax law of general application.*

In such case no taxable gain will be realized until the taxpayer's capital investment in the stock shall have first been recovered in full. *Burnet* v. *Logan*, 283 U.S. 404.

In the alternative, the measure of the taxable gain is the difference between the price realized per share on the sale and the average cost per share of all such stock held at the time of the sale. While this rule has not received the sanction of this court it has recently been applied in cases analogous to the present. *Fuller* v. *Commissioner*, 31 B.T.A. 154; *Commissioner* v. *Stifel*, F. (2d), decided February 6, 1935 (C.C.A. 4th).

ARGUMENT

I. The Commissioner's disregard of the usual incidents of stock ownership and of the admitted intention of both the taxpayer and his broker concerning the lot of shares actually sold, and the unfair and unreasonable result of the deficiency determination, clearly demonstrate error in his method of computing the proposed tax and establish the correctness of the decision below.

Preliminary to a discussion of the technical questions of law involved in the identification of stock consideration must be given to the *practical* effect of the principles for which the parties respectively contend. This court has frequently announced that taxation is an *eminently practical* matter and that where possible tax laws require a practical construction. Cf. *Tyler* v. *United States*, 281 U.S. 497, 503. The court has sought if possible to construe tax laws to give effect to the *common understanding* as to what is and is not income. *Irwin* v. *Gavit*, 268 U.S. 161, 166.

As more fully shown below, the Commissioner proposes, in effect, by an administrative regulation having no specific sanction in the taxing act, to curtail the liberty of action of a citizen in respect of his dealings with his own property. He would disregard the intention of the owner, the usual legal incidents of ownership, and the ordinary understanding of business men as to the effect and character of a normal business transaction. On the other hand, the contentions advanced by respondent and sustained by the court below, give full and fair recognition to the practical exigencies of the case, to the rights of the owner of stock, to established law relating to marginal transactions, to the intent of the taxpayer as manifested by his conduct, and to trade practices long established. The principle for which respondent contends will not have the effect of curtailing tax revenues nor open any door to tax avoidance. The point here involved concerns solely the establishment of an administrative rule which is fair both to the taxpayer and the government and which is capable of execution in a consistent manner by the tax authorities.

At the outset it is to be observed that the Revenue Act itself says nothing about earmarking and identifying stock certificates, and in the absence of any such specific provision in the taxing statute the latter should be presumed to incorporate and follow the general law and the ordinary custom of business.

(a) *A purchaser of stock on margin is the owner of the stock, and has rights and liabilities as such.*

While at one time there may have been some question as to whether a purchaser of stock on margin was the owner of the stock, it is now well settled that he is the owner and the broker a mere pledgee of the stock as security for the purchaser's indebtedness to the broker for money advanced with which to acquire the shares. *Richardson* v. *Shaw*, 209 U.S. 365; *Gorman* v. *Littlefield*, 229 U.S. 19; *Duel* v. *Hollins*, 241 U. S. 523.

right, afforded to all other classes of taxpayers, to exercise his own free will in deciding which lot and what property he wishes to sell and when to sell.

It can hardly be questioned but that the construction and application of Article 58 which the Commissioner asserts in this case serve to deny a purchaser of stock on margin fundamental rights of ownership. As so construed and applied the Article is unreasonable and void.

In Meyer on "The Law of Stock Brokers and Stock Exchanges," Sec. 42, it is said:

> "*The customer is the owner of the securities* which are purchased by the broker on his behalf. This is true *even though the purchase is made on margin. It is the judgment of the customer which determines when the securities are to be purchased and when they are to be sold. All of the incidents of ownership are in the customer.* The risk of the purchase is his, and the broker, aside from his remuneration, has no interest therein. The profits *of the transaction* are the customer's, and the losses must be sustained by him. Dividends and stock rights belong solely to him."

The *right to sell* is one of the most elementary "incidents of ownership." Turner was the owner (*Richardson* v. *Shaw, supra*) of the particular 1000 shares which he purchased in 1928 and as such he had the right to sell them when and under such conditions as he saw fit. This right is expressly contemplated in the cases. The present transaction took place in Pennsylvania. In the leading Pennsylvania case on marginal transactions, *L. H. Taylor & Co's Assigned Estate,* 192 Pa. 304, the Supreme Court of Pennsylvania said—

> "stocks are as legitimate subjects of speculative buying and selling as flour or dry goods or pig iron. A man may buy any commodity, stock included, *to sell on an expected rise* * * *."

In the leading federal case on stock identification, *Howbert* v. *Penrole*, 38 F. (2d) 577, (C.C.A. 10th, 1930), the court quoted and approved the trial court's holding that:

> "Where a party has held stock for many years, and later buys more, and in this case it is admitted that plaintiff bought a great deal more after 1913 than he sold in 1918, *he has a right to decide which stock he is going to sell.*" The Government has not the power to say that if the taxpayer sells any of his holdings in a particular company, it can say conclusively that he sold the stock bought at the cheapest price or the shares purchased before or after a certain date. He has the right to decide that himself."

It is thus apparent that Turner had the absolute right to do exactly what he did, and the right being absolute it could not possibly have been either limited or completely abrogated by the mere fact that two years earlier he had bought some of the same stock as a permanent investment. He had the absolute right to buy these 1000 shares in the spring of 1928 at about 143¼ with the purpose of selling them when the prices advanced, and to so sell them as he did when the prices advanced to about 147½. He carried out all the steps necessary to effect that sale because he did everything that was either physically or legally possible for him to do in the premises. The mechanics of buying stock on margin have long been well known to the courts. The courts have recognized all along that in such cases certificates are never earmarked for particular purchases, but that the broker is entitled to commingle them and to hold them in various names, etc., frequently known as street certificates. This court in the *Richardson* case constantly referred to these conditions in the very opinion in which it held the purchaser was the owner and in which it supported its decision by reference to the various incidents of ownership which rested in him.

But if Turner was the owner of these particular 1000 shares, which he had purchased with the idea of selling on

a rise, and if as an owner he was entitled to sell them when they did rise, there must necessarily be something wrong with a regulation which in effect says that he could not so sell them. It conflicts with the established principles of law relating to the nature of marginal transactions and the status of the parties thereto. It reads into the law something that is not there and which under the decisions cannot be implied.

The decision of the court below construed and applied Article 58 in this case in such a reasonable and fair way that Turner's rights as owner of the stock were fully safeguarded. The fairness of the result the court reached is as highly persuasive of the correctness of its decision as the unfair and discriminatory character of the Commissioner's result is indicative of error in his determination.

(c) *A further result of the Commissioner's determination is to deny any effect to the fundamental factor universally held determinative of the very legality of a marginal transaction, namely, the intent of the purchaser; this is corrected by the decision of the court below.*

A speculative purchase of stock on margin is entirely legal. This form of transaction, however, is so easily capable of abuse, particularly through what have come to be known as "bucket-shops," that the courts early had to develop a definite test to determine the legality of marginal transactions. It is most significant that the one test which has thus been universally developed by the courts to distinguish between a perfectly legal although speculative purchase of stock on margin, as in the present case, and a mere bucket-shop transaction is the *intent* of the parties and particularly the intent of the purchaser. *Embrey* v. *Jemison*, 131 U. S. 336; *L. H. Taylor & Co.'s Assigned Estate*, 192 Pa. 304; *Wagner* v. *Hildebrand*, 187 Pa. 156; *Hurd* v. *Taylor*, 181 N. Y. 231.

If then intent is the major and practically the sole factor in determining the legality or illegality of such a tran-

saction, surely one who like Turner embarks on such an undertaking is entitled to have at least some weight given to that same intent in considering the purely subordinate and collateral question of what particular stock was bought or sold in the transaction the legality of which has just been established solely by the test of intent. Turner's speculative purchase on margin of 1000 shares in June of 1928 in the hope that he could sell the stock at an enhanced price was legal because he intended that the broker should actually make such a purchase, as he in fact did. Surely by the same token Turner may resort to that same intent to prove what stock he sold in completing the very transaction the legality of which has been established in the way just mentioned.

In the *Taylor* case the question arose on a customer's claim against an insolvent broker for long purchases on margin. The lower court disallowed the claim as a gambling transaction. The Supreme Court of Pennsylvania (the state in which all the transactions here in question took place) reversed this decision because the various stocks had been bought and sold as ordered by the customer and he testified that such had always been his intent. The court said at page 306:

> "It has been settled by this Court so often that it ought not to require reiteration that dealing in stocks even on margin is not gambling. Stocks are as legitimate subjects of speculative buying and selling as flour or dry goods or pig iron. A man may buy any commodity, stock included, to sell on an expected rise, or sell 'short' to acquire and deliver on an expected fall, and it will not be gambling. Margin is nothing but security, and a man may buy on credit, with security or without, or on borrowed money, and the money may be borrowed from his broker as well as from a third person. The test is did he *intend* to buy, or only to settle on differences?"

In the *Wagner* case a broker sued a customer. The same court announced the same rule in even more terse words at page 141:

> "A purchase of stock on margin for speculation is not necessarily a gambling transaction. If it is the *intention* of the parties that a real purchase shall be made by the broker, although the delivery may be postponed or made to depend upon future conditions, the transaction is legal; if it is the *intention* that there is not to be a delivery to complete the purchase, but that the account is to be settled on the basis of a rise or fall in prices, it is a mere wager, and the contract cannot be enforced by either party."

In the *Embrey* case this court held void a contract with a broker to purchase cotton futures on margin because neither party contemplated the purchase or delivery of actual cotton, but only the settlement of the difference through a payment by one party to another. The court said:

> "The mere form of the transaction is of little consequence. If it were, the statute against wagers could easily be evaded. The essential inquiry in every case is as to the necessary effect of the contract and the *real intention* of the parties. Mr. Benjamin in his Treatise on Sales (Vol. 2, 6th Am. Ed. by Corbin, p. 716, Sec. 828), after stating that at common law wagers that did not violate any rule of public decency or morality, or any reorganized principle of public policy, were not prohibited, says: 'It has already been shown that a contract for the sale of goods to be delivered at a future day is valid, even though the seller has not the goods, nor any other means of getting them than to go into the market and buy them.' 'But such a contract,' he proceeds to say, 'is only valid where the parties really *intend* and agree that the goods are to be delivered to the seller, and the price to be paid by the buyer.' "

Both the Commissioner in his determination and the Board in its opinion (R. 10-11) sustaining him ignored the taxpayer's intention, but the opinion below, reversing the Board and overruling the Commissioner, gives full and fair recognition to Turner's intent, and this opinion is

therefore consistent with the established law governing both ordinary sales and sales of stock on margin. The court said (R. 26-27):

> "'Evidence of intention of the owner of shares in transactions of purchase and sale though not dispositive of the question of identification has, nevertheless, a bearing on the ultimate question, what the owner did about it. Commissioner v. Merchants and Manufacturers Fire Insurance Company, 72 Fed. (2d) 408; Howbert v. Penrose, 38 Fed. (2d) 577. What Turner did in this case, acting and speaking through his attorney, was to communicate to his broker his intention to hold for investment the shares of U.G.I. he originally purchased."

(d) *The admission of the government that if the taxpayer's contentions are not sustained it "simply leaves him with an unenforceable claim" in itself illustrates the arbitrary and unfair character of the Commissioner's determination and argues strongly for the correctness of the decision below.*

That something is wrong with the Commissioner's determination in this case is practically admitted in petitioner's brief at pages 6-7 where it is said that:

> "Aside from the regulation, the burden was upon the taxpayer to show the cost of what was sold. This he did not and could not do. The impossibility of proving a material fact simply leaves him with an unenforceable claim."

The court below exercised sound judgment and avoided the possibility of any such result of leaving the taxpayer "with an unforceable claim" by permitting the identification of the lot of shares sold through reasonable means.

Further discussion of points illustrating the arbitrary and unreasonable character of any holding which would deny the right of identification and permit of the application of the "first in, first out" presumption in this case

is set out in Point III, subpoints (b) and (c), of this brief, where the invalidity of the regulation is asserted.

II. The court below properly ruled that the 1000 shares held in the margin account and sold in 1928 could be and were identified as a lot purchased by taxpayer earlier in the same year; and that the cost of that specific lot is the basis for computing the taxable gain.

In the light of the arbitrary, discriminatory and unreasonable result of the Commissioner's determination in this case, as shown above, there is a strong presumption that the holding of the court below was right, and, unless insurmountable legal technicalities prohibit a holding that the 1000 shares sold were identified, it should be affirmed. It offends one's sense of fairness to say that a man shall be taken to have sold property which admittedly he intended not to sell, and did everything legally possible to retain. "The mind staggers over giving sanction to a finding that something is true which we know is not true," *United States* v. *Alpha Portland Cement Co.*, 257 Fed. 432, 434.

(a) *Shares of stock held on margin are capable of identification by the specific lots purchased and sold, the lots being earmarked by the separate transactions recorded in the books and records of the purchaser and the broker, and it is immaterial that identification can not be made through means of stock certificates.*

The government renews its discredited contention that shares of stock are not capable of identification except by certificates. *The government has never been sustained by any court in such contention,* and cites no cases supporting such a view. The decisions are the other way. As pointed out in *Snyder* v. *Commissioner,* 73 F. (2d) 5, what are bought and sold in a margin account are *shares of stock,* not certificates which are mere evidence of title to the shares which constitute the property owned. The court there held:

"From the petitioner's statement of fact and his position on the law, it is obvious he has confused identification of shares and identification of certificates in transactions of sale. The rule deals with the sale and identification of 'shares of stock in a corporation,' not with sale and identification of certificates. Shares of stock and certificates for shares of stock are different legal entities. Shares of stock 'are intangible and rest in abstract legal contemplation.' They are the interest or right which the owner has in the management, profits and assets of a corporation. 14 C.J. Secs. 506, 509. Though incorporeal, they nevertheless are property and are the subject of conversion. 14 C.J. Sec. 509; 7 R.C.L. Sec. 166; *Skinner* v. *Eaton, Collector,* 45 Fed. (2d) 568. A certificate of stock, on the other hand, is the symbol or paper evidence of the ownership of shares; it is not the stock itself. It is merely written evidence, and then only *prima facie* evidence, of the ownership thereof by the person designated therein and of the rights and liabilities resulting from such ownership. 14 C.J. Secs. 698, 701, 702, 707, 709, 710, 1043. *Howbert* v. *Penrose,* 38 Fed. (2d) 577, 579. A stockholder may prove his ownership of shares by evidence other than that of the certificate, 14 C.J. Sec. 1272; and he may dispose of his shares and surrender his title therein by sale accompanied with delivery of a certificate in his name which he has endorsed with a blank assignment and power of attorney authorizing the transfer. 14 C.J. Secs. 1033, 1050; 7 R.C.L. Secs. 239, 243. As between seller and buyer the shares pass by mere delivery of the certificate, so endorsed, though the transfer as between the new owner and the corporation is not complete until made on the books of the corporation. When the new owner of the shares sells them without first having them transferred to himself on the books of the corporation and makes delivery by handing over the certificates so endorsed in blank by the original holder and starts it on its wanderings through the 'street,' the shares may go in one direction and the certificates in another; the shares, however, always being represented (in the rapid shifting of certificates between brokers) by a like certificate in the name of another, with endorsement in blank, held

> for the owner. Then 'ownership follows the owner, not the certificate.' *Howbert* v. *Penrose*, 38 Fed. (2d) 577, 579."

The Commissioner in his brief, at page 15, referring to the decision in the *Snyder* case, urges:

> "It recognizes that in marginal transactions certificates cannot be identified, but holds that shares, as distinguished from certificates, are capable of identification. This so-called distinction does not exist in a case of this kind."

This court long ago settled the point that there *is a distinction*, and a real one, between the stock certificates and the *shares of stock*. This court has repeatedly permitted customers of bankrupt brokers to identify their stock held on margin and to recover it *without identifying the stock by earmarked certificates*. Respondent submits that a similar method of identification, by reference to the recorded transactions, is equally permissable in tax cases. Consideration of the court's decisions in these bankruptcy cases will therefore throw much light on the present question, and somewhat lengthy quotations appear justified.

The nature of the relationship between a stockbroker and a customer for whom stocks were purchased on margin, and as well as the question as to where title to the stock lies, were discussed at length in *Richardson* v. *Shaw*, 209 U.S. 365 (1908). This court in that case held that a broker who turns over to a customer stock which he is carrying on margin for that customer, or certificates for an equal number of shares, does not make the customer a preferred creditor within the meaning of the bankruptcy law. The conclusion was reached that the customer was the owner of the stock from the time of its purchase and that—

> "although the broker may not be strictly a pledgee, as understood at common law, he is, essentially, a pledgee and not the owner of the stock."

In reaching such conclusion the court pointed out the essential nature of the shareholder's property right in the stock and the distinction between the shares and the certificates therefor, saying:

> "It is objected to this view of the relation of customer and broker that the broker was not obliged to return the very stocks pledged, but might substitute other certificates for those received by him, and that this is inconsistent with ownership on the part of the customer, and shows a proprietary interest of the broker in the shares; but this contention loses sight of the fact that *the certificate of shares of stock is not the property itself, it is but the evidence of property in the shares.* The certificate, as the term implies, but certifies the ownership of the property and rights in the corporation represented by the number of shares named.
>
> A certificate of the same number of shares, although printed upon different paper and bearing a different number, represents precisely the same kind and value of property as does another certificate for a like number of shares of stock in the same corporation. It is a misconception of the nature of the certificate to say that a return of a different certificate or the right to substitute one certificate for another is a material change in the property right held by the broker for the customer. Horton v. Morgan, 19 N.Y. 170; Taussig v. Hart, 58 N.Y. 425; Skiff v. Stoddard, 63 Connecticut, 198, 218. As was said by the Court of Appeals of New York in Caswell v. Putnam, 120 N.Y. 153, 157, 'one share of stock is not different in kind or value from every other share of the same issue and company. They are unlike distinct articles of personal property which differ in kind and value, such as a horse, wagon or harness. The *stock has no earmark which distinguishes one share from another*, so as to give it any additional value or importance; like grain of a uniform quality, one bushel is of the same kind and value as another.'"

The concurring opinion of Mr. Justice Holmes is also very significant. He said:

for gold coin, could properly be treated as indistinguishable tokens of identical values. That as between themselves, after paying amount due brokers, the customer had a right to demand delivery of stocks purchased for his account; and such delivery might have been made during insolvency without creating a preference."

From these cases it is clear that a person who purchases stock is the owner of the stock; that the shares of stock constitute property as to which the certificates are mere evidence of title; that the shares of stock so purchased and owned need not be identified by stock certificates; and that the customer's rights in the shares, as evidenced by the books of account, the contracts of the parties, and the intent of the parties, will be fully respected.

It must follow that Turner immediately upon execution by his broker of the order to purchase the 1000 shares of U.G.I. stock in 1928 became the owner of the 1000 share lot. His ownership and rights were evidenced by his books and records and by those of the broker. That was a single, identifiable transaction. And the same is true with respect to each of the several previous purchases of the same stock in 1926.

In the light of the cases above cited there can be no question that upon the sale of any lot of stock Turner was not required to identify the shares by particular certificates. These cases also hold that lots of stock held on margin can in law be sufficiently identified for all practical purposes by other evidence. Under the circumstances of a marginal transaction how may identity of a particular lot be shown? Obviously by any method or evidence which unequivocally records or points out the lot intended to be sold. The record in this case does not leave any doubt as to the particular lot Turner intended to sell. Both his records and the testimony of his associates established a definite and unequivocal selection of the 1000 share lot purchased in 1928.

(b) *The identity of a lot of stock sold out of a margin account can accurately be determined by reference to the intent of the seller as evidencd by his contemporaneous acts; such a rule is fair both to the taxpayer and the government and is capable of practical application.*

Conceding the possibility of identification of shares of stock and that this may be accomplished by means other than the certificates, the question at issue reduces itself merely to the sufficiency of evidence in a given case to convince a reasonable tribunal as to which lot of stock the owner intended to sell.

The whole purpose of the regulations is to ascertain: (1) the amount of the taxpayer's investment in a stock transaction, and (2) the amount realized when the transaction is closed by a sale of the stock. Since shares of stock are intangible, and cannot be identified as such, only a *transaction* of purchase, sale, exchange, or the like is subject, in the nature of the case, to identification. Any evidence therefore sufficient to identify a specific transaction in stock must be regarded as sufficient in law.

Significantly, Article 58 only applies where "the identity of the *lots* cannot be determined." Of course a lot of stock bought on margin is identifiable by the records of the broker and of the taxpayer. Each transaction is earmarked. There is no more difficulty in identifying a specific lot of shares bought on margin than the cost of the different lots. The same records show both the lot and the cost of the same. The man in the street would certainly not conceive of any such difficulty in identification as the Commissioner purports to find. Turner's right and title to the several lots of shares, here in question, was evidenced by the entries in his own and the books of account and records of the broker. In fact, were it not for his records the Commissioner could not have ascertained that he bought one lot in 1926 and another in 1928, nor the respective costs of the lots, nor the number of shares in each lot.

There is neither occasion or reason for the identification of the thing sold being required to go further than the identification of the thing bought. The latter has been identified by the Commissioner solely from Turner's intent, his books and records, and his tax return. The stock sold may very properly be identified in the same way.

Transactions in stock on margin have long been sanctioned by the law, and established trade practices have been developed. The course of such dealings and their legal effect are considered at length in *Richardson* v. *Shaw, supra*. The customer does not get a certificate covering his stock purchased on margin, nor does the broker earmark any certificate for him. While the outright owner of shares ordinarily (but not necessarily) has specific certificates to evidence his ownership, the owner of stock on margin has only the contract between himself and the broker to evidence his ownership. Normally that contract itself is merely evidenced by the memorandum records of the parties. But the long period of marginal dealings has not demonstrated any difficulty in identifying the customer's ownership in usual course of business. The Commissioner appears to ignore this established business practice and refuses, for tax purposes, to recognize the very indicia of stock ownership which the parties themselves accept every day as competent and satisfactory evidence of the ownership which the courts hold the marginal trader has as a matter of law.

As already seen, in case of sale of stock on margin as well as in the case ordinary sales, it is the *intent of the seller* which is the controlling factor. Legality of the transaction, when title passes, etc., are all ascertained by reference to the owner's intent. Even where the customer has identifiable stock certificates and they are sold by his broker, in the absence of intent to make a sale, no sale of the stock results. *In re Woody*, 57 F. (2d) 207 (1932). Clearly intent must be the controlling factor in identification of what is sold.

If the seller offers *no evidence* whatever from which his intent may be determined with fair certainty then it may well be that some such presumption as the "first in, first out" rule should, with fairness and good reason, be resorted to in the administration of the tax law. Respondent would not contend otherwise. But where the taxpayer's intent is established by uncontroverted evidence (as in this case, where Turner's intent to sell the stock acquired in 1928 is admitted by the Commissioner to be firmly established) and no reasonable person could doubt what the seller purported to sell, the arbitrary presumption has no place.

There is no good reason, from the standpoint of good administration of the tax laws, which requires resort to an artificial rule to ascertain the stock sold. The property rights of the seller are protected and justice accomplished without violence to any principle of law or rule of convenience by permitting identification by satisfactory proof of intent. This is all that the decision of the court below requires.

A rule which will permit of identification by proof of intent is wholly practical of administration. Intent is susceptible of proof. Proof of intent is required every day in other fields of law. The Commissioner of Internal Revenue must frequently be satisfied as to a taxpayer's intent in connection with other matters. If it can be established for other legal purposes, it can be established in a case where a taxpayer holds stock in the margin account.

Apparently the Commissioner desires to establish a rule of thumb which will permit his auditors to compute the gain or loss on the sale of stock held on margin without reference to the true facts. But when such an easy way out does violence to the very fundamental incidents of ownership in property and results in the realization of a taxable gain (or loss) never intended by the taxpayer, obviously the protection of the rights of the citizen far out-

weigh any consideration of convenience in auditing tax returns.

Where a taxpayer, as in this case, by clear and convincing evidence establishes the *lots* of marginal stock to be sold, that is sufficient identification; where there is no such clear earmarking of the *lot* sold there is no identification. That seems to be the principle of law involved in this case. It is hard to see how any such holding can possibly, as petitioner suggests, "create considerable confusion and doubt as to the proper rules to be applied in these cases."

Obviously no principle can be formulated which will relieve the taxing officials and the Board from considering evidence in particular cases as they arise, or from their duty to make findings of fact as to whether the taxpayer did or did not by properly *manifested* intent and consistent performance designate the lot of shares in his margin account to be sold.

(c) *The decision below is in full harmony with established principles of the law of marginal transactions and the law of sales.*

The opinion of the court below in this case was handed down the same day as its opinion in the *Snyder* case, and the latter opinion was cited and relied on as establishing the law in respect of identification. There the court ruled that stock held on margin was capable of identification, citing many authorities. The relevant portion of that opinion is quoted *ante* page. It is to be observed that the conclusion of the court respecting the possibility of identification of stock, by means other than certificates, is entirely consistent with and sustained by this court's opinions in *Richardson* v. *Shaw*, *Gorman* v. *Littlefield* and *Duel* v. *Hollins*, heretofore quoted and discussed.

The consistency of the decision of the court below in this tax case with decisions in other fields involving stock held on margin speaks much for the soundness and correctness of the judgment.

(d) *The holding below is entirely consistent with and is supported by the decision of the federal courts in tax cases involving identification of stock sold.*

In addition to its consistency with opinions of this court and with other authorities in the general field of the law, the decision below is fully supported by and is wholly consistent with other court decisions in the narrower field of stock identification for tax purposes. The court cites and relies on these other cases. Aside from *Cole* v. *Helburn*, 4 F. Supp. 230, petitioner cites no other court cases. Petitioner cites several Board of Tax Appeals cases, but admittedly certain of the opinions of the Board can neither be reconciled with each other nor with the court decisions.

The court below held in substance that shares of stock are capable of identification; that the law does not require identification by earmarking certificates; that the intent of the seller must be considered in making identification; that a mere mental intent, not crystalized into action, is insufficient from the standpoint of satisfactory evidence; and that intent of the seller as shown by his statements and performance is sufficient. Such holdings are severally consistent with the decided cases dealing with identification of stock and the application of the "first in, first out" rule. *Howbert* v. *Penrose*, 38 F. (2d) 577; *Skinner* v. *Eaton*, 45 F. (2d) 568; *Snyder* v. *Commissioner*, 54 F. (2d) 57; *Horner* v. *Commissioner*, 72 F. (2d) 407; *Commissioner* v. *Merchant's & Mfgrs. Fire Insurance Co.*, 72 F. (2d) 408; *Snyder* v. *Commissioner*, 73 F. (2d) 5; *Cole* v. *Helburn*, 4 F. Supp. 230. See also *Towne* v. *McElligott*, 274 Fed. 960. The validity of the rule, when construed merely as a presumption as to the shares sold *where no evidence is offered as to identity of lots and dates of purchase*, was not questioned in those cases. It is not questioned in this case, if construed to permit a taxpayer to identify his shares after the manner employed by Turner here.

The cases cited all agree on those fundamental principles concerning the law of identification. With respect to the decision in a particular case on the point of the sufficiency of the evidence to satisfy the demands of reasonable certainty, an astute lawyer might argue that a different conclusion should have been reached in some of the cases.

This brief would be unduly lengthened by a detailed consideration of the cases cited. They all tend to sustain respondent's contentions; certainly none requires a contrary holding. In the petition for the writ (p. 5) it was suggested that the decision below was in conflict with *Skinner* v. *Eaton*, but that case did not even involve stock purchased on margin. In that case there was some evidence of the taxpayer's intent, *expressed several years previous to the sale*, to retain his first purchases but no proof that any effort was made to carry this intention into effect or to keep a record of ths stocks acquired and sold. Here Turner communicated his intent to the broker and *did everything that it was possible to do to identify the lot of shares to be sold* and especially to preclude the sale of the lot purchased in 1926. The *Skinner* case did not hold, nor even suggest as *dicta* that shares of stock purchased on margin *could not* be identified, or that shares could *only* be identified by certificate numbers.

Howbert v. *Penrose, supra*, is not only consistent with the decision below, but seems to go further and to hold that the declared intention of the taxpayer as to what stock is to be sold is sufficient in itself. The two *Snyder* cases did, however, involve marginal transactions. They were decided by the same court which decided this case, and the second *Snyder* case was decided the very same day as the present. The court distinguished those cases on their facts and it cannot reasonably be contended the two decisions thus simultaneously rendered are in conflict. Neither the *Horner* nor the *Merchants* cases involved marginal transactions and there can be no conflict. They

are cases where the stock actually identified as sold was not that intended to be sold. *Cole* v. *Helburn*, 4 F. Supp. 230, did not involve a marginal sale, and was simply a case where no instructions were given the broker as to what stock to sell.

It is significant that the Board of Tax Appeals has cited the decision below with approval and as being consistent with the previously decided cases by the courts and the Board. See *George Vawter* v. *Commissioner*, 31 B.T.A. 884.

(e) *The facts in the present case are sufficient to distinguish it from Snyder v. Helvering, No. 663, now pending before this court.*

The court below, consistently with prior decisions, ruled identification to be "a matter of fact" (R. 45), and upon a careful consideration of the evidence held it to establish that Turner as a matter of fact had identified the stock sold in October and November, 1928, as being the lot purchased in June, 1928. The case thus turned on the weight and sufficiency of the evidence to support the Board's conclusions, and the Board was reversed because of its failure to give effect to the communication of Turner's intention to his broker respecting the specific lots of stock to be sold and not to be sold, and to the corroborating evidence as to identification.

The court did not, as suggested at page 7 of the petition for the writ, allow "a mere declaration of intention to take the place of the factual identification required by the regulation"; it was careful to point out that under the decided cases, "his 'intention' • • • clearly was not enough to take the case out of the rule" (R. 46), and that there was "something else" in this case (R. 45). This "something else" was stated (R. 46) to be:

> "What Turner did in this case, acting and speaking through his attorney, was to communicate to his broker his intention to hold for investment the shares of U.G.I. he originally purchased. His decisions to

> sell like shares later purchased were reached on that basis; his books and records were kept on that basis; and, accordingly, his income tax return was made on that basis.".

Hence the present case differs from the *Snyder* case principally on the point of sufficiency of the evidence. There is no difference in the fundamental question of law involved.

In the present case there is concrete evidence that taxpayer's mental intent to retain the 1926 lot was crystalized into definite, recorded action from which no inference can be drawn other than that such stock should not be sold. *Turner's performance, as well as his intent, was only consistent with a hypothesis of identification of the 1928 lot.* Apparently in the *Snyder* case the court did not consider the taxpayer's intention to be sufficiently manifested by overt acts as to permit full effect to be given to the intention. Snyder may have had the intent to sell certain classes of stock but he did nothing of a definite recorded character to carry such intention into effect. Turner did everything that he reasonably could do to designate, at or before the sale, which stock should be retained and which sold. The broker had his instructions.

The distinction between the present case and cases where mere intent is proved (as in the *Snyder* case) is recognized and concisely stated by the Board in *Vawter* v. *Commissioner*, 31 B.T.A. 884, 886, as follows:

> "Intention alone, it has frequently been held, is not a criterion, *Skinner v. Eaton, supra; Courtenay D. Allington, supra;* nor is the taxpayer's mere mental or verbal labeling of the shares sold. *The claimed identification must at least be consistent with his actual performance, Horner* v. *Commissioner, supra; Commissioner* v. *Merchants' & Manufacturers' Fire Insurance Co., supra; Rankin* v. *Commissioner*, 73 Fed. (2d) 9."

Respondent here will leave to Snyder's counsel argument as to whether the evidence in his case was, under the

principles discussed in this brief, sufficient to require the same judgment there as in the present case. But respondent does contend that there is no inconsistency between the lower court's simultaneous decisions in the two cases, and that this court could, on the difference in the evidence, affirm both judgments.

III. Even if the 1000 shares sold were not identified, the Commissioner's artificial and arbitrary "first in, first out" rule does not control this case.

On this branch* of the case there are two considerations —does Article 58, by its terms, apply; and, if so, is it valid as applied to marginal stock transactions? The Commissioner's brief does not touch on the first question, which is discussed below. The second of these questions also has a twofold aspect—is the regulation valid as applied to ordinary stock transactions; and, if so, is it also valid as applied to stock transactions in a marginal account?

(a) *By its very terms Article 58, Regulations 74, providing for the "first in, first out" presumption, can not be applied in cases like the present.*

This article, so far as here material, provides:

> "When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock."

By its very terms it is applicable only when stock is sold "from *lots* purchased at different dates and at different prices." That is distinctly not the case here. The evidence shows that the 1000 shares of stock were sold from the one single lot of 1000 purchased at one date and at one price (R. 9).

---

*Counsel must beg the court's indulgence for the length of this brief, but the necessity for presenting an alternative argument leaves no other course open. If the court agrees that Turner identified the stock, no consideration is required of this and the remaining points.

'no earmark which distinguishes one share from another'," and on the very next page urges that "The usual method of identification is, of course, by tracing the shares through certificates."

It is therefore difficult to gauge the Commissioner's real contention in this case. He must take one or the other of the two positions—either that shares of stock are legally capable of identification, or that they are not. If the first position is assumed, it would seem to follow, for reasons fully set forth in Point II of this brief, that there was a sufficient identification here of the 1000 shares sold in 1928; if the second position is assumed, it must follow that Article 58 can not be applied because it was only intended to be effective and can only reasonably control in cases where identifiable property is involved.

The design of the regulation is to identify the shares sold out of certain "lots" which are assumed to be capable of identification. If the property is of such an intangible and unitary character that no separate part can be distinguished, obviously a "first in, first out" presumption can not be applied, because it will prove equally as impossible to identify the shares "first in" as those "first out."

It is respondent's contention, of course, that shares of stock are capable of identification by lots, as heretofore shown. However, it must be admitted that the question is not entirely free from doubt. It has not been touched upon by this court in any income tax decision. For tax purposes it has heretofore been considered that shares are subject to identification and in many cases this has proven a workable principle. Where, however, stock has been held a long time, where there have been stock dividends, changes in par value, exchange of certificates, loans of stock paid back with other similar stock, etc., the rule has given rise to great practical difficulties. In the recent case of *Alvan T. Fuller* v. *Commissioner*, 31 B.T.A. 154, the

Commissioner attempted to apply the "first in, first out" presumption, and the Board found:

> "The basis * * * used by the Commissioner in determining the profit on the sale of the 25,000 shares was derived from an elaborate and complicated computation made by a revenue agent, *which consumed 11 full pages* of the agent's report."

In G.C.M. 11742 (Int. Rev. Bull. XII-2, p. 31) there is an excellent example of the complications encountered in the administration of the presumption. It was there admitted that:

> "While this may appear at first glance to be carrying the presumption of 'first in, first out' to rather ridiculous extremes, it must be recognized that, at best, the presumption is simply an arbitrary 'rule of thumb' which the courts have upheld."

That illustrates the logical and usual consequence of holding that shares may be identified, and of attempting to apply its correlative principle that upon failure to identify in fact, the presumption should apply.

Only recently the Board of Tax Appeals in *Vawter* v. *Commissioner*, 31 B.T.A. 886, pointed out the difficulty of reconciling the principle of *Richardson* v. *Shaw* with the theory of Article 58, saying:

> "The rule is one of administrative convenience and necessity, the purposes of which are uniformity of taxation, certainty of determination, and simplicity of computation. Broadly speaking shares of the same class are fungible, each representing a proportionate interest in the whole and each new acquisition being absorbed into the expanding interest of the shareholder. *Richardson* v. *Shaw*, 209 U.S. 365; *Duel* v. *Hollins*, 241 U.S. 523; *Howbert* v. *Penrose*, *supra*; *Snyder* v. *Commissioner*, *supra*; *Burdett Stryker*, 21 B.T.A. 561. In this sense shares defy identification. *To what extent the administrative practice departs from this concept or upon what theory the concept is modified so as to recognize an identification is difficult to learn from the cases which have been litigated.*"

The point which respondent makes here is that should this court hold shares of stock incapable of identification, as a matter of law, then the "first in, first out" presumption can not be applied and resort must be had to other principles of tax law, considered in Point IV, to measure the gain or loss.

(c) *If shares of stock held on margin are incapable of identification the "first in, first out" rule cannot be applied in case of a sale of such stock, because it would create an irrebuttable presumption of fact and thereby be unconstitutional, as denying due process of law.*

Whatever may be the Commissioner's position as to whether shares of stock generally are capable of identification, it is clear from his brief that he takes the definite position that (p. 10) "particular shares held on margin are not identifiable." Even if the court agrees with this contention it does not follow that the "first in, first out" rule may be applied here. The validity of the regulation in the light of its application to such a case as this must also be considered.

It is submitted that, as applied to shares of stock held on margin and regarded as not subject to identification, the regulation creates an irrebuttable presumption of fact, which this court will not sanction. The point is controlled by *Heiner* v. *Donnan*, 258 U.S. 312.

In the *Donnan* case the court held void a provision in a federal estate tax law establishing a conclusive presumption that every gift made by a decedent within two years of death was in contemplation of death. The provision was held unconstitutional as in violation of the Fifth Amendment. The court said:

> "a statute which imposes a tax upon an assumption of fact which the taxpayer is forbidden to controvert, is so arbitrary and unreasonable that it cannot stand.
>
> * * * * * * * * *
>
> This court has held more than once that a statute *creating a presumption which operates to deny a fair*

opportunity to rebut it violates the due process clause of the Fourteenth Amendment. For example, *Bailey* v. *Alabama*, 219 U.S. 238; *et seq.*; *Manley* v. *Georgia*, 279 U.S. 1, 5-6. 'It is apparent,' this court said in the *Bailey* case (p. 239) 'that a constitutional prohibition *cannot be transgressed indirectly* by the creation of a statutory presumption any more than it can be violated by direct enactment. The power to create presumptions is not a means of escape from constitutional restrictions.' "

In *Manley* v. *Georgia*, 279 U.S. 1, 6, the court held:

"A *prima facie* presumption casts upon the person against whom it is applied the duty of going forward with his evidence on the particular point to which the presumption relates. A statute creating a presumption that is arbitrary or *that operates to deny a fair opportunity to rebut it* violates the due process clause of the Fourteenth Amendment. *Bailey* v. *Alabama*, 219 U.S. 219, 233 *et seq. Mere legislative fiat may not take the place of fact in the determination of issues involving life, liberty or property.*"

From the Commissioner's concession that shares of stock held on margin are not capable of identification, and that in every such case it must be taken, *as a fact*, that the first shares purchased were those first sold, it follows that the effect of Article 58, if applied to such shares, is to create a presumption which operates to deny a fair opportunity to rebut it.

The Commissioner urges at page 21 of his brief that "Since the attack is on the ground that the due process clause is violated, the question is simply whether the regulation is reasonable." Even assuming, for sake of argument, this is the controlling issue, the answer does not aid petitioner's case. The unreasonable and discriminatory effect of the regulation in this case is fully discussed in Point I. There may be cases where the regulation may be enforced fairly and reasonably, but it is all too clear that the application of the article here produces an absurd and

wholly unreasonable result. The Commissioner by its application found that Turner in 1928 sold a part of the 1200 shares purchased in 1926 (R. 9). Clearly he owned these 1200 shares (*Richardson* v. *Shaw*) and equally clearly he intended to keep them. One of the incidents of that *ownership* for purposes of the income tax acts is the right "to decide" to keep certain shares and to sell certain shares. *Howbert* v. *Penrose,* 28 F. (2d) 577, 578. He did decide to do a certain thing, he had a right to do that thing, and he did everything within his power to do it, and if any regulation arbitrarily and unnecessarily says he must be presumed to have done just the opposite thing, that regulation is obviously unreasonable. That the provisions of the Article are arbitrary has been expressly ruled. *Snyder* v. *Commissioner,* 54 F. (2d) 57-58. That it is necessary only "in the absence of something else" is ruled in the same paragraph of the opinion in that case. It cannot therefore be necessary where as here there is no "absence of something else." On the contrary, as shown in Point II, *supra,* there is here very much more "something else" than there was in the *Snyder* case.

Furthermore, this court will take judicial notice of the extensive volume of trading in stocks on margin. This is an established method of business dealing. To be reasonable any tax regulation must be designed to take into account the normal established course of marginal transactions. It should provide a rule which will not unduly discriminate between those taxpayers who purchase stocks outright and those who purchase on margin. Both contribute substantially to the federal revenues. A reasonable rule must either permit of identification in a fashion such as employed in this case or must dispense entirely with the necessity for identification of shares. No rule can be reasonable which will wholly deny the right to identify, and thereby place the marginal trader at distinct tax disadvantage as compared with others dealing in shares of stock. In law both have the same rights of ownership in

stock (*Richardson* v. *Shaw, supra*) and both should sustain the same tax liability upon a sale of like property.

Construed to apply to shares of stock regarded as legally incapable of identification, it is submitted that Article 58 is arbitrary and unreasonable, and, under the decided cases, therefore unconstitutional and void. *Robinson v. Lundrigan*, 227 U. S. 173. It can have no effect in the present case.

IV. If for any reason the "first in, first out" rule does not control, and if the shares sold are not identified, then the taxable profit must be ascertained under established principles of income tax law of general application.

In the preceding point three distinct reasons why Article 58 does not control in this case are discussed. If for any reason (and there may be others equally as cogent as those advanced herein by respondent) the "first in, first out" presumption can not here be applied, and the court further holds Turner did not identify the shares sold, then the question arises as to how to determine the base for ascertaining gain or loss on the sale of the shares. One of two principles of tax law would seem to apply. Both are discussed below.

(a) *In such case no taxable gain will be realized until the taxpayer's capital investment in the stock shall have first been recovered in full.*

In the absence of identification and of any controlling tax regulation the general principle of law applicable is that announced by this court in *Burnet* v. *Logan*, 283 U.S. 404. That, too, was a case of sale of shares of stock. The facts were somewhat different, but a general principle was announced which is equally applicable in all cases where for one reason or another it is impractical to compute exactly how much of each receipt is profit. In that fundamental respect that case and the present one are substantially alike and the general rule applied in one must from

its very nature be equally applicable in the other. There a block of stock had been sold for a lump sum plus a future annual payment of an indeterminate amount. The question was what part, if any, of the first payment was profit, which is identically the same question as in the present case. There, as here, the Commissioner had proposed an arbitrary method (in that case a prorating of each dollar received as part return of cost and part profit), but he had no duly promulgated regulations to support him. This court said at page 412:

> "The circuit court of appeals held that, in the circumstances it was impossible to determine with fair certainty the market value of the agreement by the Youngstown Company to pay 60 cents per ton. *Also, that respondent was entitled to the return of her capital*—the value of 250 shares on March 1, 1913, and the assessed value of the interest derived from her mother—*before she could be charged with any taxable Income. As this had not in fact been returned, there was no taxable income.*
>
> *We agree with the result reached by the circuit court of appeals.*
>
> The 1916 transaction was a sale of stock—not an exchange of property. We are not dealing with royalties or deductions from gross income because of depletion of mining property. Nor does the situation demand that an effort be made to place according to the best available date some approximate value upon the contract for future payments. This probably was necessary in order to assess the mother's estate. *As annual payments* on account of extracted ore *come in they can be readily apportioned first as return of capital and later as profit. The liability for income tax ultimately can be fairly determined without resort to mere estimates, assumptions and speculation. When the profit, if any, is actually realized, the taxpayer will be required to respond.* The consideration for the sale was $2,200,000.00, in cash and the promise of future money payments wholly contingent upon facts and circumstances not possible to foretell with anything like fair certainty. The promise was in no proper

> sense equivalent to cash. It had no ascertainable fair market value. The transaction was not a closed one. Respondent might never recoup her capital investment from payments only conditionally promised. Prior to 1921 all receipts from the sale of her shares amounted to less than their value on March 1, 1913. *She properly demanded the return of her capital investment before assessment of any taxable profit based on conjecture.*"

By a curious coincidence, which is not altogether without significance, a later sentence of Article 58 provides, with regard to the sale of stock acquired under somewhat different circumstances, as follows:

> "Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sale shall have been recovered the total cost."

That two additional and entirely different principles should be thus in effect legislated into this very same article of the regulations does not speak any too strongly for the reasonableness and the fairness of the third principle for which petitioner contends in this case. Passing that by, however, the important thing is that the same article of the regulations recognizes prorating, and if that is inapplicable, then a complete withdrawal of investment untaxed before any profit is realized as being at least equally reasonable. This last principle that no profit is realized on any sale of part of the stock until out of the proceeds of the sales the total cost has been recovered is the one recognized in the *Logan* case as generally applicable in the absence of any valid regulation.

Respondent contends that the 1000 shares sold in the fall of 1928 have been identified and that there was a substanial profit and a corresponding tax thereon as originally returned by Turner. But if this court should hold otherwise respondent submits that in no event is the presumption of Article 58 applicable, and that in that event the profit, if any, must be determined in accordance with the principle approved and applied in the *Logan* case.

(b) *In the alternative the measure of the taxable gain is the difference between the price realized per share on the sale and the average cost per share of all such stock held at the time of the sale.*

It will be observed that this alternative suggestion that the cost be apportioned to the shares held is recognized by the provision of Article 58, quoted above, as proper where stock is received as a bonus and some method of allocating the purchase price is necessary.

This principle has recently been applied by the Board of Tax Appeals to stock received in a non-taxable reorganization in exchange for stock previously held, the cost of the old stock being required to be apportioned ratable to the new shares. *Fuller* v. *Commissioner*, 31 B.T.A. 154; *Oliver* v. *Commissioner*, 30 B.T.A. 1380; *Von Gunten* v. *Commissioner*, 28 B.T.A. 702. In *Commissioner* v. *Stifel*, decided February 6, 1935, the Circuit Court of Appeals for the Fourth Circuit affirmed the Board in applying such averaging principle under the same circumstances. Cf. *Ayer v. Blair*, 25 F. (2d) 534.

The principle of allocating the cost to the number of unidentified shares held is also supported by decisions in cases involving the estates of bankrupt stock brokers. It is held that where the estate is found to have a lesser number of unearmarked shares of a particular stock on hand than the broker is obligated to deliver, his customers, although unable to identify their respective shares, are en-

titled to receive *pro rata* parts of the shares on hand. *Duel* v. *Hollins*, 241 U. S. 523.

Furthermore, it may be argued with some force that a shareholder has but a single divisible interest in a corporation, which may be evidenced for convenience by any number of distinct stock certificates. On such a view a sale of a part of his stock is but a disposition of a proportionate part of his undivided interest. It would follow, for tax purposes, that the basis for determining gain or loss upon a sale of stock would in any event be that proportion of the total cost of the shareholder's interest which the number of shares sold bears to the total number owned at the time of the sale.

The apportionment principle has the advantage of simplicity of application, and perhaps conforms more nearly to the method customarily used by the average business man. Respondent submits that either this rule or that of first recovery of capital investment (*Burnet* v. *Logan*, *supra*) afford reasonable means of determining the cost basis to be used in computing gain or loss upon the sale of any stock which is legally incapable of identification.

Conclusion

It is submitted that the decision below is correct and is in harmony with the decided case. The judgment should be affirmed.

Respectfully submitted,

John W. Townsend,
Counsel for Respondent.

March, 1935.

CORRECTED COPY

P. 7

SUPREME COURT OF THE UNITED STATES.

No. 582.—October Term, 1934.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* James L. Rankin, Executor. } On Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[April 29, 1935.]

Mr. Justice Brandeis delivered the opinion of the Court.

The Revenue Act of 1928 (c. 852, §§ 22, 111, 112, 113) provides, as had earlier Revenue Acts, that in computing income from sales of property purchased after February 28, 1913, any excess of the amount realized over cost shall be gain and that any excess of the cost over the amount realized shall be loss. When gain or loss is to be determined on the sale of stock owned outright as an investment, the identification of the shares sold with those purchased ordinarily presents no difficulty. But when the taxpayer has engaged in marginal transactions on a stock exchange, the identification of sales and purchases is frequently impossible. It was, perhaps, primarily to deal with such cases that the Treasury adopted, in 1918,[1] the so-called "First-in, first-out" rule. That rule appears in Article 58 of Regulations No. 74, under Revenue Act of 1928, as follows:

"When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots can not be determined, the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over cost or other basis of the stock will constitute gain."

Applying this rule, the Commissioner of Internal Revenue assessed against Richard B. Turner for the year 1928, a deficiency tax of $11,173.05 on account of gains from his operations on the stock exchange in United Gas Improvement Co. stock. Upon a redetermination by the Board of Tax Appeals, the Commissioner's action was sustained. 26 B. T. A. 1204. The Court of Appeals reversed the Board's decision and directed it to enter a new order

[1] Art. 4, ¶ 60, Regulations No. 33 (Revised), Revenue Acts of 1916 and 1917; Art. 39, Regulations Nos. 45, 62, 65 and 69, Acts of 1918, 1921, 1924 and 1926, respectively; Art. 58, Regulations Nos. 74 and 77, Acts of 1928 and 1932 respectively; Art. 22 (a)-8, Regulations No. 86, Act of 1934.

in conformity with the court's opinion. 73 F. (2d) 9. Turner having died during the litigation, his executor, Rankin, was substituted. Writs of certiorari were granted in this case, and in *Snyder* v. *Commissioner of Internal Revenue*, No. 663, decided this day, in order to determine questions concerning the effect, validity, and applicability of the regulation. 293 U. S. —. The facts found by the Board were these:

In 1926, Turner received in distribution of his father's estate $20,000 in bonds. Wishing to change his inheritance into stock, he opened a marginal account with a stock broker; sold the bonds; and, with the proceeds as margin, purchased, from time to time during that year, an aggregate of 1,200 shares of United Gas Improvement Company stock at a cost of $117,202.50. On this stock the broker received for him, later in 1926, 300 shares as a dividend. There were no further operations in 1926 or in 1927. His marginal account became active in 1928. At the beginning of the year he was long 1,500 shares of this stock; in May he sold 300 shares for $44,619 net; in June, he bought 1,000 shares for $143,225; in October he sold 500 shares for $73,865; and, in November, 500 shares for $74,115. Thus, at the close of the year, he was long 1,200 shares.

In none of these transactions did the broker deliver to Turner, or Turner to the broker, any stock certificate. No specific certificate of stock was ever bought or sold by the broker for Turner; and none was earmarked or allocated for him in any manner. The purchases and sales affecting his account were made through the medium of street certificates handled by the broker; and the transactions were evidenced solely by debits and credits in his account on the broker's books. Turner first learned these facts after the deficiency assessment. He had always intended to retain ownership on margin of 1,200 shares of the stock, since he had faith in the company and desired to hold them in lieu of the bonds which he had received from the estate of his father. To his business associates, who acted for him in giving orders to the broker, he had made it plain that the 1,200 shares were in the nature of a permanent commitment on his part. An employee of the broker understood that the decedent desired to retain 1,200 shares of the stock to take the place of the bonds which he had received from his father.

On the above facts the Board concluded, as had the Commissioner, that it was impossible to determine the identity of the lots

purchased and sold; and that, consequently, the "First-in, first-out" regulation should be applied. In reversing that order the Court of Appeals said:

"We think the petitioner's [Turner's] communication to his broker of his intention to hold the 1,200 shares first purchased as an investment was in effect an order to his broker not to sell those shares, and when, two years later, he ordered the broker to make two sales in lots of 500 shares each, they were, conformably with the original instructions, the 1,000 shares last purchased. The petitioner's instructions excluding from sale the shares first purchased were in effect an identification of the shares later sold as those last purchased.

While the petitioner, in identifying his shares, might have been more specific in his instructions to his broker, those he gave stand uncontradicted; indeed they have not been questioned. We think they were enough to take the case out of the rule and that, in consequence, the deficiency tax in issue is invalid to the extent that it is based on gains in sales of U. G. I. shares reckoned on the purchase price of the original 1,200 shares."

First. The Commissioner contends that Turner's communication to his broker of his intention to keep 1,200 shares of United Gas Improvement Co. stock was ineffective to identify the shares to be sold, because, from the very nature of these marginal operations, the shares were incapable of identification by the broker or anyone else. The basis for this contention are the facts that in such transactions no certificate is issued in the name of the customer, or earmarked for or otherwise allocated to him; that all certificates are in the name of the broker or street names; and that all certificates for stock of the same kind are commingled and held by the broker for the common benefit of all dealing in that particular stock. The fallacy of this argument lies in the assumption that shares of stock can be identified only through stock certificates. It is true that certificates provide the ordinary means of identification. But it is not true that they are the only possible means. Compare *Richardson* v. *Shaw*, 209 U. S. 365; *Gorman* v. *Littlefield*, 229 U. S. 19; *Duel* v. *Hallins*, 241 U. S. 523. Particularly is this so when, as here, the thing to be established is the allocation of lots sold to lots purchased at different dates and different prices.[2]

[2]The original regulation, Art. 4, ¶ 60, Regulation No. 33 (Revised), read, "When stock is sold from lots purchased at different times and at different prices, and the identity of the lots can not be determined as to the dates of purchase, the stock sold shall be charged against the earliest purchases of such stock." It has been suggested that, "Under the language quoted from

The required identification is satisfied, if the margin trader has, through his broker, designated the securities to be sold as those purchased on a particular date and at a particular price. It is only when such a designation was not made at the time of the sale, or is not shown, that the "First-in, first-out" rule is to be applied.[3]

Second. The validity of the regulation, thus construed, cannot seriously be questioned. The contention advanced by the taxpayers, both here and in the companion case of *Snyder* v. *Helvering*, that the regulation, as applied to marginal transactions, is invalid under the Fifth Amendment, because it creates a conclusive presumption, must rest wholly on the assumption that the shares traded on margin are incapable of identification. Since that assumption is erroneous, it is clear that no conclusive presumption is established. It is, at most, the burden of proof that is affected. For the margin trader, while being required to establish the identity of the shares in order to avoid the "First-in, first-out" rule, is left free to introduce any relevant evidence. Nor is he arbitrarily deprived of any of the important attributes of ownership, such as the "right to decide which stock he is going to sell." Indeed it is conceded, at least by the taxpayer in this case, that the regulation, as we now interpret it, "provides a useful and reasonable rule for ascertaining what stock was sold in cases where there is no proof, or lack of satisfactory proof, of the fact."

Third. If the facts found by the Board of Tax Appeals had been what the Court of Appeals assumed them to be, there would have been such an identification of shares sold with shares purchased as to preclude the Commissioner from applying the "First-in, first-out" rule. The Court of Appeals assumed that, "What Turner did in this case, acting and speaking through his attorney, was to communicate to his broker his intention to hold for investment the shares of U. G. I. he originally purchased." The facts found by the Board of Tax Appeals do not bear out this assumption of the court. The Board's findings were that, "The decedent

---

Regulations 33, ["as to the dates of purchase", omitted in subsequent regulations] it might be argued that the identification intended could have been accomplished merely by recording 'the dates of purchase', rather than by requiring physical identification of the certificates." Wilkins, Identity of Marginal Transactions, Int. Rev. News, v. 4, no. 7, p. 5 (1931).

[3]Compare Howbert v. Penrose, 38 F. (2d) 577; Skinner v. Eaton, 45 F. (2d) 568; Snyder v. Comm'r of Internal Revenue, 54 F. (2d) 57; Comm'r of Internal Revenue v. Merchants' & Mfrs' Ins. Co., 72 F. (2d) 408.

[Turner] always intended to retain the ownership on margin of 1,200 shares of the United Gas Improvement Co. stock"; and that, "An employee of the broker understood . . . . that the decedent desired to retain 1,200 shares to take the place of the bonds which he had received from his father." The difference between the Board's findings and the court's statement of the facts is obviously vital. The court held that Turner's communication of his intention "was in effect an order to his broker not to sell those shares"; that "when, two years later, he ordered the broker to make two sales in lots of 500 shares each, they were, conformably to the original instructions, the 1,000 shares last purchased." But if the employee was told, as the Board found; merely that Turner "desired to retain 1,200 shares [of the U. G. I. stock] to take the place of the bonds which he had received from his father", he would naturally believe that so long as any 1,200 shares of the stock were retained, it was immaterial to which of the lots the sales in 1928 were attributed; and hence there was no identification. Thus it was only by departing from the facts as found by the Board of Tax Appeals that the court found justification for reversing the Board's decision.

Fourth. The Court of Appeals is without power, on review of proceedings of the Board of Tax Appeals, to make any findings of fact. "The Board of Tax Appeals is not a court. It is an executive or administrative board, upon the decisions of which the parties are given an opportunity to base a petition for review to the courts after the administrative inquiry of the Board has been had and decided." *Old Colony Trust Co.* v. *Commissioner of Internal Revenue*, 279 U. S. 716, 725. The function of the court is to decide whether the correct rule of law was applied to the facts found; and whether there was substantial evidence before the Board to support the findings made. See *Phillips* v. *Commissioner of Internal Revenue*, 283 U. S. 589, 599, 600; *Burnet* v. *Leininger*, 285 U. S. 136, 138; *Old Mission Portland Cement Co.* v. *Helvering*, 293 U. S. 289, 294.[4] Unless the finding of the Board involves a mixed question of law and fact, the court may not properly substitute its own judg-

[4]Compare Tracy *v.* Comm'r of Internal Revenue, 53 F. (2d) 575, 578-9; Slayton *v.* Comm'r of Internal Revenue, decided March 26, 1935, by the Circuit Court of Appeals for the First Circuit; Heywood Boot & Shoe Co. *v.* Comm'r of Internal Revenue, decided April 1, 1935, by the Circuit Court of Appeals for the First Circuit.

ment for that of the Board.[5] If the Board has failed to make an essential finding and the record on review is insufficient to provide the basis for a final determination, the proper procedure is to remand the case for further proceedings before the Board. Compare *Helvering v. Taylor,* 293 U. S. 507; *Murphy Oil Co. v. Burnet,* 287 U. S. 299, 308.[6] And the same procedure is appropriate even when the findings omitted by the Board might be supplied from examination of the record.[7]

Fifth. The Court of Appeals did not comment on the difference between the Board's findings and its own statement of the facts. Apparently it assumed that there was no difference, and reversed the Board's order, believing that it rested upon an erroneous ruling of law. For the court said that the Board made its determination "on the theory that the U. G. I. stock, which from time to time he [Turner] purchased on margin, and later sold, could be identified only by certificates; that as no certificates for shares were ever in his name, the shares sold could not be identified as shares purchased in any particular lot or at any particular time or price and, accordingly, charged the shares sold against those earliest purchased within the 'First in, first out' rule."

There is nothing in the opinion of the Board to indicate that its decision was based upon the "theory" stated by the court. There is nothing in the record to indicate that any such contention had been made by the Government before the Board; and Turner's petition for review by the Court of Appeals did not claim that the Board had acted upon that "theory".[8] But even if the Board's

[5]Compare Bishoff *v.* Comm'r of Internal Revenue, 27 F. (2d) 91, 92; Washburn *v.* Comm'r of Internal Revenue, 51 F. (2d) 949, 951; Tricou *v.* Helvering, 68 F. (2d) 280, 285.

[6]Compare Royal Packing Co. *v.* Comm'r of Internal Revenue, 22 F. (2d) 536, 538; Comm'r of Internal Revenue *v.* Langwell Real Estate Corp., 47 F. (2d) 841, 842; Independent I. & C. Storage Co. *v.* Comm'r of Internal Revenue, 50 F. (2d) 31, 33; Kansas City Southern Ry. Co. *v.* Comm'r of Internal Revenue, 52 F. (2d) 372, 379; Houston *v.* Comm'r of Internal Revenue, 53 F. (2d) 445; Underwood *v.* Comm'r of Internal Revenue, 56 F. (2d) 67, 73; Eau Clair Book & Stationery Co. *v.* Comm'r of Internal Revenue, 65 F. (2d) 125, 126.

[7]Compare Kendrick Coal & Dock Co. *v.* Comm'r of Int. Rev., 29 F. (2d) 559, 564; Francisco Sugar Co. *v.* Comm'r of Internal Revenue, 47 F. (2d) 555, 558; Beldridge Oil Co. *v.* Helvering, 69 F. (2d) 432.

[8]The Solicitor General stated in his petition to this Court for certiorari, that the question presented was "whether shares of stock held on margin are capable of identification so that a taxpayer selling part of his holdings may select, as his basis for determining gain or loss, the cost of any particular lot"; and counsel for the Government may have contended in the Court of Appeals, as he did here, that such identification is impossible. It is also true that the Board of Tax Appeals in other cases has approved the rule for which the Government is now contending. See Stryker *v.* Comm'r of Internal

decision had been based on an erroneous rule of law, that would not have justified its reversal, if the findings of fact, governed by the correct rule of law, were sufficient to sustain the decision and had substantial support in the evidence.[9]

Sixth. The Court of Appeals did not explicitly hold that the Board's finding as to Turner's communication to his broker was without substantial support in the evidence. The court, in its opinion, does state that, "The evidence shows conclusively that Turner was sentimental about keeping the original 1,200 shares as an inheritance from his father; that his 'intention' was to retain as an investment the shares originally purchased and sell in speculation the shares more recently acquired". It does not state that the evidence was equally conclusive as to the communication to the broker of this exact intention. There was, it is true, testimony to the effect that "from the very beginning West & Company knew Mr. Turner's intentions and knew he was keeping the first purchase of 1,200 shares"; and the failure of the Board so to find, was assigned as error by the taxpayer in his petition for review. But there was also testimony showing that Turner, during 1928, traded heavily in 20 other issues of stock. The Court of Appeals did not consider whether, in view of this and other evidence, the Board might reasonably have concluded that the testimony as to the broker's knowledge of Turner's intention was not entirely accurate, and that the broker's only clear understanding of Turner's intention was that, throughout his extensive trading, 1,200 shares of United Gas Improvement Co. stock were to remain in his account. Since this question was not considered in the court below nor argued here, the case must be remanded to the Court of Appeals for further consideration.

Reversed.

Mr. Justice STONE thinks that the judgment of the Court of Appeals should be reversed and the order of the Board of Tax Appeals affirmed, on the grounds that the petitioner failed to show that the particular shares sold were capable of identification with respect to the date of their purchase, and that they could not be identified merely by designating them to the broker as the shares to be sold.

Revenue, 21 B. T. A. 561; Leng *v.* Comm'r of Internal Revenue, 22 B. T. A. 149; Seelye *v.* Comm'r of Internal Revenue, 29 B. T. A. 695; compare Kelchner *v.* Comm'r of Internal Revenue, 31 B. T. A. 262.

[9]Compare Lewis-Hall Iron Works *v.* Blair, 23 F. (2d) 972, 974-5; Hurwitz *v.* Comm'r of Internal Revenue, 45 F. (2d) 780, 781; Dickey *v.* Burnet, 56 F. (2d) 917, 918.